

SUNAIR ELECTRONICS INC

Form PRE 14A

January 06, 2005

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**SCHEDULE 14A
(RULE 14a-101)**

**INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION**

**Proxy Statement Pursuant to Section 14(A)
of the Securities Exchange Act of 1934**

Filed by the registrant x

Filed by a party other than the registrant o

Check the appropriate box:

- x Preliminary proxy statement
- o **Confidential, For Use of the Commission only (as permitted by Rule 14a-6(e)(2))**
- o Definitive proxy statement
- o Definitive additional materials
- o Soliciting material pursuant to Rule 14a-11(c) or Rule 14a-12

SUNAIR ELECTRONICS, INC.

(Name of Registrant as Specified in Its Charter)

Payment of filing fee (Check the appropriate box):

- x No fee required.
- o Fee computed on the table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11:

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

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- o Fee paid previously with preliminary materials.
 - o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the form or schedule and the date of its filing.
 - (1) Amount previously paid:
 - (2) Form, schedule or registration statement no.:
 - (3) Filing party:
 - (4) Date Filed:
-

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**SUNAIR ELECTRONICS, INC.
3005 S.W. THIRD AVENUE
FT. LAUDERDALE, FL 33315**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS
TO BE HELD ON FEBRUARY 4, 2005**

To our shareholders:

The Annual Meeting of Shareholders (the Annual Meeting) of Sunair Electronics, Inc. (the Company, us, our or we) will be held at the Embassy Suites, 1100 SE 17th St., Fort Lauderdale, FL 33316 on February 4, 2005 at 10:00 am, local time, for the following purposes:

- (1) To approve the issuance of shares of our common stock in connection with our proposed sale to Coconut Palm Capital Investors II, Ltd., a Florida limited partnership (Coconut Palm) of up to 5,000,000 units at a purchase price of \$5.00 per unit. Each unit will consist of: (i) one share of our common stock; (ii) a warrant to purchase one additional share of our common stock, at an exercise price of \$6.00 per share, which will be immediately exercisable and will expire after three years; and (iii) a warrant to purchase one additional share of our common stock, at an exercise price of \$7.00 per share, which will be immediately exercisable and will expire after five years;
 - (2) To increase the size of our Board of Directors from 5 to 7 members;
 - (3) To approve amendments to our Articles of Incorporation to: (i) change our corporate name to Sunair, Inc.; (ii) allow the Company to engage in any lawful business; and (iii) increase the number of our authorized shares of capital stock to 108,000,000 shares, of which 100,000,000 shares will be common stock and 8,000,000 shares will be preferred stock (Proposals 1, 2 and 3 are collectively referred to as the Transaction);
 - (4) To elect 6 members, including Richard C. Rochon and Mario B. Ferrari (both of whom are nominees and affiliates of Coconut Palm), to our Board of Directors, each to serve until the 2005 Annual Meeting of Shareholders or until their successors have been duly elected and qualified, with the 1 additional newly created vacancy set forth in Proposal 2 above to be filled by a Coconut Palm nominee. In addition, if Steven P. Oppenheim, who is one of the director nominees, is elected by our shareholders at the Annual Meeting, he will resign from our Board of Directors upon the closing of the Transaction, and Coconut Palm will have the right to nominate an additional director to fill the vacancy created by Mr. Oppenheim s resignation. Each of the Coconut Palm nominees will be elected by a majority vote of our Board of Directors within 30 days of the creation of each of the respective vacancies, as provided by our bylaws;
 - (5) To approve the issuance of an aggregate of 60,000 options to purchase shares of our common stock to 3 of our current directors outside of our existing stock option plan;
 - (6) To approve our 2004 Stock Incentive Plan; and
 - (7) To act upon such other business as may properly come before the Annual Meeting and any and all adjournments or postponements of the Annual Meeting.
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While the proposals in this proxy statement are being listed separately for purposes of voting, Proposals 1, 2 and 3 are all interdependent. Accordingly, obtaining the requisite shareholder approval for each such proposal is a condition precedent to the effectiveness of the other such proposals. In addition, that portion of Proposal 4 relating to the election of Messrs. Rochon and Ferrari to our Board of Directors, the resignation of Mr. Oppenheim from our Board of Directors and the filling of the 2 vacancies by Coconut Palm nominees (including the 1 additional newly created vacancy if Proposal 2 is approved by our shareholders, and the vacancy created by Mr. Oppenheim's resignation), are each contingent upon the closing of the Transaction. If the Transaction does not close: (i) the election of Messrs. Rochon and Ferrari to our Board of Directors will not become effective; (ii) Mr. Oppenheim will not resign from our Board of Directors; and (iii) Coconut Palm will not fill any vacancies on our Board of Directors. That portion of Proposal 4 relating to the election of Messrs. Herman, Heggstad, Laurent and Oppenheim, Proposal 5, relating to the issuance of an aggregate of 60,000 options to purchase shares of our common stock to 3 of our current directors outside of our existing stock option plan, and Proposal 6, relating to the approval of our 2004 Stock Incentive Plan, are each independent of the other proposals in this proxy statement and will become effective, if approved, irrespective of whether our shareholders approve the Transaction.

All shareholders of record at the close of business on [January 7, 2005] will be entitled to vote at the Annual Meeting or any adjournments or postponements thereof.

By Order of the Board of Directors

/s/ SYNNOTT B. DURHAM

Synnott B. Durham

Secretary and Chief Financial Officer

Fort Lauderdale, FL

[January 18, 2005]

This is an important meeting and you are invited to attend the Annual Meeting in person. Whether or not you expect to be present at the Annual Meeting, please complete, sign and date the enclosed proxy card and return it promptly in the enclosed return envelope. No postage is required if mailed in the United States. Shareholders who execute a proxy card may nevertheless attend the Annual Meeting, revoke their proxy and vote their shares in person.

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**SUNAIR ELECTRONICS, INC.
3005 S.W. THIRD AVENUE
FT. LAUDERDALE, FL 33315**

**PROXY STATEMENT
ANNUAL MEETING OF SHAREHOLDERS**

This proxy statement is furnished in connection with the solicitation by the Board of Directors of Sunair Electronics, Inc. (the Company, us, our or we), of proxies to be used with respect to the matters to be voted upon at the Annual Meeting of Shareholders (the Annual Meeting) to be held on February 4, 2005, beginning at 10:00 am, local time, at the Embassy Suites, 1100 SE 17th St., Fort Lauderdale, FL 33316, and at any adjournments or postponements thereof.

The approximate date that this proxy statement and the enclosed form of proxy are first being sent to shareholders is [January 19, 2005]. You should review the information provided in this proxy statement together with our Annual Report on Form 10-KSB for the fiscal year ended September 30, 2004, which is being delivered to shareholders simultaneously with this proxy statement. The cost of solicitation of proxies is being borne by the Company.

PURPOSES OF THE ANNUAL MEETING

At the Annual Meeting, our shareholders will consider and vote upon the following matters:

- (1) the issuance of shares of our common stock in connection with our proposed sale to Coconut Palm Capital Investors II, Ltd., a Florida limited partnership (Coconut Palm) of up to 5,000,000 units at a purchase price of \$5.00 per unit. Each unit will consist of: (i) one share of our common stock; (ii) a warrant to purchase one additional share of our common stock, at an exercise price of \$6.00 per share, which will be immediately exercisable and will expire after three years; and (iii) a warrant to purchase one additional share of our common stock, at an exercise price of \$7.00 per share, which will be immediately exercisable and will expire after five years;
 - (2) an increase in the size of our Board of Directors from 5 to 7 members;
 - (3) the approval of amendments to our Articles of Incorporation to: (i) change our corporate name to Sunair, Inc.; (ii) allow the Company to engage in any lawful business; and (iii) increase the number of our authorized shares of capital stock to 108,000,000 shares, of which 100,000,000 shares will be common stock and 8,000,000 shares will be preferred stock (Proposals 1, 2 and 3 are collectively referred to as the Transaction);
 - (4) the election of 6 members, including Richard C. Rochon and Mario B. Ferrari (both of whom are nominees and affiliates of Coconut Palm), to our Board of Directors, each to serve until the 2005 Annual Meeting of Shareholders or until their successors have been duly elected and qualified, with the 1 additional newly created vacancy set forth in Proposal 2 above to be filled by a Coconut Palm nominee. In addition, if Steven P. Oppenheim, who is one of the director nominees, is elected by our shareholders at the Annual Meeting, he will resign from our Board of Directors upon the closing of the Transaction, and Coconut Palm will have the right to nominate an additional director to fill the vacancy created by Mr. Oppenheim s resignation. Each of the Coconut Palm nominees will be elected by a majority vote of our Board of Directors within 30 days of the creation of each of the respective vacancies, as provided by our bylaws;
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- (5) the approval of the issuance of an aggregate of 60,000 options to purchase shares of our common stock to 3 of our current directors outside of our existing stock option plan;
- (6) the approval of our 2004 Stock Incentive Plan; and
- (7) any other business as may properly come before the Annual Meeting and any and all adjournments or postponements of the Annual Meeting.

While the proposals in this proxy statement are being listed separately for purposes of voting, Proposals 1, 2 and 3 are all interdependent. Accordingly, obtaining the requisite shareholder approval for each such proposal is a condition precedent to the effectiveness of the other such proposals. In addition that portion of Proposal 4 relating to the election of Messrs. Rochon and Ferrari to our Board of Directors, the resignation of Mr. Oppenheim from our Board of Directors and the filling of the 2 vacancies by Coconut Palm nominees (including the 1 additional newly created vacancy if Proposal 2 is approved by our shareholders, and the vacancy created by Mr. Oppenheim's resignation), are each contingent upon the closing of the Transaction. If the Transaction does not close: (i) the election of Messrs. Rochon and Ferrari to our Board of Directors will not become effective; (ii) Mr. Oppenheim will not resign from our Board of Directors; and (iii) Coconut Palm will not fill any vacancies on our Board of Directors. That portion of Proposal 4 relating to the election of Messrs. Herman, Heggstad, Laurent and Oppenheim, Proposal 5, relating to the issuance of an aggregate of 60,000 options to purchase shares of our common stock to 3 of our current directors outside of our existing stock option plan, and Proposal 6, relating to the approval of our 2004 Stock Incentive Plan, are each independent of the other proposals in this proxy statement and will become effective, if approved, irrespective of whether our shareholders approve the Transaction.

Our Board of Directors considered and evaluated the Transaction mentioned above. In connection with its evaluation, our Board of Directors engaged Paul D. DeStefanis, P.A. d/b/a Advanced Business Valuations to act as its financial advisor. Advanced Business Valuations has rendered its opinion, dated as of November 16, 2004 to the effect that, as of that date and based upon and subject to the assumptions, limitations and qualifications set forth in its opinion, the issuance of the units at the price stated in this proxy statement is fair, from a financial point of view, to our shareholders. A copy of this opinion is attached to the accompanying proxy statement as Annex A.

Our Board of Directors has determined that the: (i) Transaction; (ii) election of the 6 nominees to our Board of Directors; (iii) issuance of options to purchase shares of our common stock to 3 of our current directors; and (iv) approval of our 2004 Stock Incentive Plan are in our best interests and the best interests of our shareholders. Our Board of Directors has approved, and unanimously recommends that you vote in favor of the: (i) Transaction; (ii) issuance of options to purchase shares of our common stock to 3 of our current directors; and (iii) approval of our 2004 Stock Incentive Plan. In addition, our Board of Directors has approved the nomination of, and unanimously recommends that you vote to elect, each of the 6 nominees to our Board of Directors.

As of the record date, [January 7, 2005], there were issued and outstanding [4,014,870] shares of our common stock. Only shareholders of record as of the close of business on such date will be entitled to notice of, and to vote at, the Annual Meeting. Proxies may be revoked at any time prior to the Annual Meeting by giving written notice of revocation to our corporate Secretary, by giving a later dated proxy, or by attending the Annual Meeting and voting in person.

Brokers who hold shares in street name for customers have the authority under the rules of the various stock exchanges to vote on certain items when they have not received instructions from the beneficial owners of our common stock. Brokers that do not receive instructions from such beneficial owners of our common stock are entitled to vote those shares with respect to Proposal 4 but cannot vote on the other Proposals at the Annual Meeting. Shares for which brokers have not received instructions, and therefore are not voted with respect to a certain proposal, are

referred to as broker non-votes.

Under Florida law and our Articles of Incorporation, the presence in person or by proxy of shareholders entitled to cast a majority of all votes entitled to be cast on the matters at the Annual Meeting constitutes a quorum. A share that is represented for any purpose is deemed present for quorum purposes. Therefore, abstentions and

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broker non-votes will count for purposes of determining if there is a quorum present at the Annual Meeting, will have no effect on Proposal 4 and will count as no votes for the other Proposals.

This proxy statement is first being mailed to our shareholders on or about [January 19, 2005]. A copy of our Annual Report on Form 10-KSB for the fiscal year ended September 30, 2004, except for exhibits, accompanies this proxy statement and is incorporated in this proxy statement by reference. Upon request, we will provide copies of the exhibits to the Annual Report on Form 10-KSB at no additional cost. All requests for copies should be directed to our corporate Secretary c/o Sunair Electronics, Inc., 3005 S.W. Third Avenue, Ft. Lauderdale, FL 33315.

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SUMMARY TERM SHEET

This term sheet provides a summary of the material terms of the proposed sale of up to 5,000,000 units, at a purchase price of \$5.00 per unit, to Coconut Palm Capital Investors II, Ltd. (Coconut Palm), and the transactions contemplated in the purchase agreement between us and Coconut Palm, including without limitation, an increase in the size of our Board of Directors from 5 to 7 members and amendments to our Articles of Incorporation (collectively referred to as the Transaction). This term sheet does not contain all of the information regarding the Transaction that you may consider important. To better understand the Transaction, as well as the other proposals that you are voting on at the Annual Meeting of Shareholders (the Annual Meeting), you should carefully read this entire document, its attachments and the other documents to which we refer.

On November 17, 2004, we announced that we had entered into a purchase agreement with Coconut Palm that is conditioned upon, among other things, our shareholders approval of the issuance of shares of our common stock in connection with the purchase agreement.

We are proposing to issue and sell to Coconut Palm up to a total of 5,000,000 units at a purchase price of \$5.00 per unit as follows: (i) 3,000,000 units for an aggregate purchase price of \$15,000,000; and (ii) at the option of Coconut Palm, up to an additional 2,000,000 units for an aggregate purchase price of up to \$10,000,000, pursuant to an exemption from registration under Section 4(2) of the Securities Act of 1933, as amended. (See Description of the Purchase Agreement on page 44).

Each unit will consist of: (i) one share of our common stock; (ii) a warrant to purchase one additional share of our common stock, at an exercise price of \$6.00 per share, which will be immediately exercisable and will expire after three years; and (iii) a warrant to purchase one additional share of our common stock, at an exercise price of \$7.00 per share, which will be immediately exercisable and will expire after five years. (See Summary on page 4).

The initial purchase price of \$15,000,000 for the 3,000,000 units, and the additional purchase price of up to \$10,000,000, if Coconut Palm exercises its option to purchase up to 2,000,000 additional units, will be payable in cash.

We have been investigating strategic alternatives to our current line of business since January 2004, and we intend to use the proceeds from the sale of the units to form a new Pest and Termite Control Services Division and to enter the pest and termite control services industry by targeting potential acquisitions, or initial acquisitions, of pest and termite control services companies in the United States and its territories. The growth of our new Pest and Termite Control Services Division may also be financed by accessing the equity and debt capital markets to the extent access to such markets is deemed to be favorable by our Board of Directors. (See Description of the Purchase Agreement on page 44).

Ultimately, we anticipate that, with the sale of the units and the formation of the Pest and Termite Control Services Division, we will no longer operate solely through our traditional business segments. In the long term, we expect the Pest and Termite Control Services Division to become our dominant operation. Accordingly, we also agreed in the purchase agreement to use our best efforts to enter into a definitive agreement as soon as practicable to divest ourselves of certain non-core assets acquired in connection with our purchase of: (i) Percipia, Inc. and its wholly-owned subsidiary Percipia Networks, Inc.; and (ii) the assets of Telecom FM, at a purchase price equal to the amount we paid for such assets plus the amount of any intercompany debt incurred and advances made in connection with such purchases. The non-core assets are currently held in separate wholly-owned subsidiaries. (See Shift in Focus of Business on page 15).

As a result of the shift in focus of our business, we have also agreed to amend our Articles of Incorporation to: (i) change our corporate name from Sunair Electronics, Inc. to Sunair, Inc.; (ii) change the description of the general nature of our business from the electronics industry to any business permitted by law; and (iii) increase the number of our authorized shares of capital stock to 108,000,000 shares, of which 100,000,000 shares will be common stock and 8,000,000 shares will be preferred stock. Such changes to our Articles of Incorporation are subject to shareholder approval. (See Amendment to our Articles of Incorporation on page 28).

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To further assist in the shift in focus of our business, we have agreed, upon the closing of the Transaction, to employ John J. Hayes as our President and Chief Executive Officer, and Donald K. Karnes and David M. Slott as executive officers of our newly created Pest and Termite Control Services Division. The anticipated aggregate compensation we will pay to Messrs. Hayes, Karnes and Slott will be approximately \$975,000 in annual salary plus options to purchase 500,000 shares of our common stock at an exercise price of \$5.00 per share, which options will be granted outside of our existing stock option plan. Messrs. Hayes, Karnes and Slott will also be entitled to participate in our new stock option plan after the closing. Messrs. Hayes, Karnes and Slott previously served as executives with TruGreen, the lawn care services division of The ServiceMaster Company (ServiceMaster). On December 10, 2004, ServiceMaster filed a suit against Messrs. Hayes, Karnes and Slott. We are not a party to this action. ServiceMaster alleged in its complaint that Messrs. Karnes and Slott had breached certain non-compete agreements with TruGreen and that Hayes had induced Karnes and Slott to breach these agreements. The complaint alleges that all three individuals had breached fiduciary duties owed to ServiceMaster, that the three individuals had usurped certain corporate opportunities and misappropriated trade secrets and that the three individuals would interfere with ServiceMaster's business relations with its customers and employees. The suit seeks to enjoin the named parties from performing services of any kind for any entity, including our company, planning to provide pest and termite control services. A hearing on this matter was first held on December 10, 2004. At this hearing, the Court restrained the named individuals from soliciting for employment any person who is, or within three months of the proposed hiring date was, an employee of TruGreen or its affiliates, including but not limited to Terminix, and from using or disclosing ServiceMaster's confidential information or trade secrets. The Court refused, however, to restrain the named individuals from (i) pursuing acquisitions of pest and termite control businesses identified as potential acquisition candidates, or (ii) performing, encouraging or inducing others to perform services for any entity, including our company, or from performing services competitive with those provided to TruGreen or its affiliates, including Terminix. A full evidentiary hearing on ServiceMaster's motion to enjoin the named individuals will be held on January 24, 2005. The purchase agreement contains a closing condition that the referenced individuals have not been enjoined from performing the contemplated services for the Pest and Termite Control Services Division. Although we and Coconut Palm have indicated our intent to consummate the Transaction regardless of the outcome of the January 24, 2005 evidentiary hearing, either we or Coconut Palm may attempt to terminate the Transaction if the hearing results in an injunction against Messrs. Karnes, Slott and Hayes. (See Nominations of Specified Directors to our Board of Directors and Additions to our Management Team on page 33).

We have also agreed, upon the closing of the Transaction, to enter into a 5 year management services agreement with an affiliate of Coconut Palm, RPC Financial Advisors, LLC (RPC), to provide management services for our Pest and Termite Control Services Division, pursuant to which we will pay a management fee during the first year of an amount equal to 1/16 times the aggregate purchase price paid for the units by Coconut Palm. Following the first year and thereafter, the management fee will be equal to 1% of the gross revenues from operations of our new Pest and Termite Control Services Division. Certain officers and directors of RPC will also serve as members of our Board of Directors upon the closing of the Transaction. (See Description of the Management Services Agreement on page 49).

In connection with the Transaction, our Board of Directors has approved the nominations of Richard C. Rochon and Mario B. Ferrari, affiliates of Coconut Palm, to our Board of Directors, as Chairman and Vice Chairman, respectively. (See Nominees on page 31). We have also agreed, provided our shareholders vote in favor of expanding our Board of Directors from 5 to 7 members, to allow Coconut Palm to nominate 1 additional director to fill the newly created vacancy on our Board of Directors. In addition, if Steven P. Oppenheim, who is one of the director nominees, is elected by our shareholders at the Annual Meeting, he will resign from our Board of Directors upon the closing of the Transaction, and Coconut Palm will have the right to nominate an additional director to fill the vacancy created by Mr. Oppenheim's resignation. Each of the Coconut Palm nominees will be elected by a majority vote of our Board of Directors within 30 days of the creation of each of the respective vacancies, as provided by our bylaws. (See Increase in the Size of our Board of Directors from 5 to 7 Members on page 27).

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Coconut Palm and our Chairman, Michael D. Herman, who beneficially owns approximately 51% of our currently outstanding common stock, have entered into a voting agreement pursuant to which Mr. Herman has agreed to vote all the shares of our common stock beneficially owned by him in favor of the Transaction, subject to termination of the voting agreement upon the earlier to occur of: (i) consummation of the Transaction; (ii) any termination of the purchase agreement in accordance with its terms; or (iii) our Board of Directors' withdrawal of its approval of the Transaction pursuant to Section 8(n) of the purchase agreement. (See Description of the Voting Agreement on page 49).

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SUMMARY

This summary highlights selected information from this proxy statement and may not contain all of the information that is important to you. To understand the proposed transaction fully and for a more complete description of the terms of the transaction, you should read carefully this entire document, including the annexes, and the documents to which we have referred you.

The Entities to the Transaction

Sunair Electronics, Inc.
3005 S.W. Third Avenue
Ft. Lauderdale, FL 33315
(954) 525-1505

We are a Florida corporation organized in 1956. We are engaged in the design, manufacture and sale of high frequency single sideband communications equipment utilized for long range voice and data communications in fixed station, airborne, mobile and marine para-military applications.

Coconut Palm Capital Investors II, Ltd.
595 South Federal Highway
Boca Raton, Florida 33342
(561) 955-7300

Coconut Palm Capital Investors II, Ltd. (Coconut Palm) has informed us that: (i) Coconut Palm was formed as a special-purpose entity by Richard C. Rochon to acquire equity interests in our company; (ii) Coconut Palm is an affiliate of Royal Palm Capital Partners, LLLP (Royal Palm); (iii) Royal Palm is a private equity investment and management firm whose Chairman and Chief Executive Officer, Richard. C. Rochon, served for 14 years as President of Huizenga Holdings, Inc. (Huizenga Holdings), a management and holding company owned by H. Wayne Huizenga; and (iv) Huizenga Holdings' investments included several publicly-held companies that became market leaders in their respective industries, including Blockbuster Entertainment Corporation, Republic Waste Industries, Inc., AutoNation, Inc., and Boca Resorts, Inc.

Proposed Sale of up to 5,000,000 Units to Coconut Palm (page 13)

If our shareholders approve Proposals 1, 2 and 3 set forth in this proxy statement (such proposals are collectively referred to as the Transaction), subject to specified conditions, we will issue and sell to Coconut Palm up to a total of 5,000,000 units at a purchase price of \$5.00 per unit as follows: (i) 3,000,000 units for an aggregate purchase price of \$15,000,000; and (ii) at the option of Coconut Palm, up to an additional 2,000,000 units for an aggregate purchase price of up to \$10,000,000, in accordance with the purchase agreement between us. The purchase agreement is attached as Annex B to this proxy statement. We urge you to carefully read the purchase agreement in its entirety.

Under the purchase agreement, Coconut Palm is obligated to purchase 3,000,000 units at the closing, subject to the satisfaction of specified conditions. Coconut Palm has the right, but not the obligation, to elect to purchase up to 2,000,000 additional units within 5 days prior to the closing of the Transaction. The closing of the purchase of the 2,000,000 additional units is anticipated to occur at the same time as the closing of the 3,000,000 units; however, if, despite our best efforts, we and Coconut Palm are unable to close on the purchase of the 2,000,000 additional units at such time, then we and Coconut Palm may mutually agree on a closing date which may not be later than 7 business days after the closing of the 3,000,000 units.

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Each unit will consist of the following:

one share of our common stock;

a warrant to purchase one additional share of our common stock, at an exercise price of \$6.00 per share, which will be immediately exercisable and will expire after three years; and

a warrant to purchase one additional share of our common stock, at an exercise price of \$7.00 per share, which will be immediately exercisable and will expire after five years.

Coconut Palm has advised us that, at some time after the closing of the Transaction and from time to time, it may separate the shares of common stock and warrants comprising the units into the securities that comprise them. There are no prohibitions against this separation in the transaction documents so long as the separation and subsequent distribution is in compliance with applicable securities laws.

Increase in the Size of Our Board of Directors (page 27)

Pursuant to the purchase agreement, we have agreed to increase the size of our Board of Directors from 5 to 7 members, and to allow Coconut Palm to nominate 1 additional director to fill the newly created vacancy. In addition, if Steven P. Oppenheim, who is one of the director nominees, is elected by our shareholders at the Annual Meeting, he will resign from our Board of Directors upon the closing of the Transaction, and Coconut Palm will have the right to nominate an additional director to fill the vacancy created by Mr. Oppenheim's resignation. Each of the nominees will be elected by a majority vote of our Board of Directors within 30 days of the creation of each of the respective vacancies, as provided by our bylaws. Our Articles of Incorporation state that our Board of Directors must consist of 3 to 11 members, and that such number may be set from time to time in accordance with our bylaws. Our bylaws state that the number of directors on our Board of Directors must be determined by our shareholders. Our Board of Directors presently consists of 5 members. Therefore, we are seeking shareholder approval to fix the size of our Board of Directors at 7 members.

Amendments to our Articles of Incorporation (page 28)

Following the closing of the Transaction, we plan to pursue a strategic alternative to our current line of business by entering into the pest and termite control services industry. As a result of such shift in focus of our business, we have also agreed to amend our Articles of Incorporation to: (i) change our corporate name from Sunair Electronics, Inc. to Sunair, Inc., (ii) change the description of the general nature of our business from the electronics industry to any business permitted by law; and (iii) increase the number of our authorized shares of capital stock to 108,000,000 shares, of which 100,000,000 shares will be common stock and 8,000,000 shares will be preferred stock. Such amendments to our Articles of Incorporation are subject to shareholder approval.

No Dissenters' Rights of Appraisal (page 16)

Our shareholders will not have the opportunity to dissent from the Transaction or to receive an agreed or judicially appraised value for their shares of common stock.

Recommendation of our Board of Directors and Reasons for the Transaction (page 16)

We have been investigating strategic alternatives to our current line of business since January 2004. We believe that, notwithstanding the fact that we have enjoyed the benefits of experienced and qualified employees and executives as well as periods of positive cash flow, our business has not been growing at a rate we believe it could achieve and is generally in need of a new or additional industry focus as a catalyst for growth. When we were

approached by Coconut Palm, we believed the best interests of our shareholders required us to pursue an opportunity for an investment from Coconut Palm and to use the cash resources, as well as the experience and other resources Coconut Palm could offer, to pursue a strategic alternative to our current line of business by entering into the pest and termite control services industry. In making this determination, we considered that Richard C. Rochon had, in

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our opinion, a positive history of investing in and improving companies. Although we cannot assure you pursuing a strategic alternative in the pest and termite control services industry will ultimately benefit us and lead to increased profitability, we believe undertaking this aggressive growth strategy is in our best interests at this point in our company's life.

In formulating our decision to pursue the pest and termite control services industry, our Board of Directors reviewed the characteristics of the sector with respect to its key operating characteristics, competitive landscape, comparable transactions, and comparable companies. Based on this review, our Board of Directors made the following observations:

The pest and termite control services industry, a highly fragmented industry which is actively consolidating, represents \$6.8 billion in annual revenues distributed among approximately 20,000 firms.

The sector is dominated by a number of large players (e.g. Terminix International, Orkin Pest Control, Ecolab Pest Elimination and others) who together make up a large percentage of the market. The remainder of the market consists of small companies with under \$100 million in sales.

Competition in the market for pest and termite control services is strong, coming mainly from the larger noted companies and thousands of regional and local independently owned firms to homeowners who treat their own pest and termite control problems.

Revenue growth in the sector for the larger companies has been relatively flat in recent years, while the entire market growth rate is approximately 10% per year.

There are significant economies of scale advantages through the consolidation of pest and termite control companies.

There are no publicly listed companies in the United States that are exclusively engaged in the pest and termite control services industry. Paul D. DeStefanis, P.A. d/b/a Advanced Business Valuations reviewed the financial characteristics of several companies in the industrials-diversified commercial services industry, including The ServiceMaster Company, Ecolab, Inc., ABM Industries, and Carlisle Holdings Ltd. Advanced Business Valuations noted that the equity value-to-revenue multiples ranged from 1.04 to 2.23 times, and equity value to earnings multiples ranged from 22.90 to 29.91 times.

We believe that our company will experience rapid growth as a result of Coconut Palm's investment. We also believe the experience, skills and resources contributed by the Coconut Palm principals will offer significant benefits towards implementing our strategic alternative in the pest and termite control services industry.

Our Board of Directors has evaluated the terms of the Transaction with Coconut Palm and has considered whether to approve the issuance and sale of the units and whether the Transaction would be in our best interests and the best interests of our shareholders.

These and other factors led our Board of Directors to determine that the Transaction is in our best interests and in the best interests of our shareholders and to recommend that our shareholders approve the Transaction. We intend to complete the Transaction as soon as possible after the Annual Meeting of Shareholders.

Each member of our Board of Directors individually stated for the record his vote in favor of and approval of the Board of Directors' determination that the Transaction was in the best interests of our company and our shareholders.

Opinion of Financial Advisor (page 18)

In deciding to approve the Transaction, our Board of Directors considered the opinion of its financial advisor, Paul D. DeStefanis, P.A. d/b/a Advanced Business Valuations, that the issuance of the units at the price

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stated in this proxy statement is fair, from a financial point of view, to our company and our shareholders. The opinion of our financial advisor is attached as Annex A to this proxy statement.

Annual Meeting Date; Record Date; Voting Power (page 11)

Our Annual Meeting of Shareholders (the Annual Meeting) will be held on February 4, 2005 at 10:00 am, local time, at the Embassy Suites, 1100 SE 17th St., Fort Lauderdale, FL, 33316.

You are entitled to vote at the Annual Meeting if you own shares of our common stock as of the close of business on [January 7, 2005], the record date.

At the close of business on [January 7, 2005], the record date, [4,014,870] shares of our common stock were outstanding and entitled to vote at the Annual Meeting. You will have one vote at the Annual Meeting for each share of our common stock that you own as of the record date.

Whether or not you plan to attend the Annual Meeting, please sign, date and return the accompanying proxy card to us. You may revoke your proxy at any time before it is exercised by giving written notice to our corporate Secretary at the address listed above. You may also revoke your proxy by attending the Annual Meeting, but only if (i) you have provided the written notice discussed above or (ii) you vote by ballot at the Annual Meeting.

The affirmative vote of the majority of the votes cast by the holders of our common stock present or represented by proxy and voting on the matter is required to approve: (i) the issuance of shares of our common stock in connection with our proposed sale of up to 5,000,000 units to Coconut Palm, as described in Proposal 1; (ii) an increase in the size of our Board of Directors from 5 to 7 members, with the 1 additional newly created vacancy to be filled by a Coconut Palm nominee and elected by a majority vote of our Board of Directors within 30 days of the Annual Meeting; (iii) the issuance of an aggregate of 60,000 options to purchase shares of our common stock to 3 of our current directors outside of our existing stock option plan, as described in Proposal 5; and (iv) the approval of our 2004 Stock Incentive Plan, as described in Proposal 6.

The affirmative vote of the holders of a majority of the shares of our common stock entitled to vote on the matter is required to approve the amendments to our Articles of Incorporation, as described in Proposal 3.

The affirmative vote of a plurality of the votes cast by our shareholders is required to approve the election of the 6 nominees to our Board of Directors, as described in Proposal 4.

Ownership Following the Transaction; Consequences of the Transaction; Future Plans (page 50)

Coconut Palm may acquire up to 5,000,000 shares of our common stock in the Transaction and, provided Coconut Palm purchases all 5,000,000 shares of our common stock, will be entitled to purchase up to an additional 10,000,000 shares of our common stock upon exercise of the warrants. Based on that number and the number of shares of our common stock outstanding on [January 7, 2005], the record date, if Coconut Palm: (i) purchases only the 3,000,000 units, Coconut Palm will acquire approximately 43% of our common stock outstanding immediately after the closing of the Transaction; (ii) exercises its option to purchase the 2,000,000 additional units, Coconut Palm will acquire approximately 56% of our common stock outstanding immediately after the closing of the Transaction. In addition, Coconut Palm will be entitled, on a fully diluted basis, to acquire up to: (i) 69% of our common stock outstanding immediately after the closing of the Transaction, upon exercise of the 6,000,000 warrants acquired in connection with the purchase of the 3,000,000 units; and (ii) 79% of our common stock outstanding immediately after the closing of the Transaction upon exercise of an additional 4,000,000 warrants, if Coconut Palm exercises its option to purchase the 2,000,000 additional units. If Coconut Palm were to: (i) exercise its option to purchase up to 2,000,000 additional

units; (ii) exercise the warrants acquired with the 3,000,000 units or (iii) exercise the warrants acquired if it exercises its option to purchase the 2,000,000 additional units, it would have enough shares of our common stock to control our company.

Two of the nominees for election to our Board of Directors, Richard C. Rochon and Mario B. Ferrari, are designees of Coconut Palm. Coconut Palm has advised us that Messrs. Rochon and Ferrari are expected to

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eventually receive some of the units, or the securities comprising the units, purchased by Coconut Palm as a distribution from Coconut Palm for performance of services by Messrs. Rochon and Ferrari.

As Coconut Palm is a partnership, it may ultimately distribute the units to its partners and/or principals, which may have the effect of eliminating any control Coconut Palm acquires. Coconut Palm has not informed us of any intent to distribute any of the units, or any portion of the securities comprising the units, to anyone other than Messrs. Rochon and Ferrari. Coconut Palm has agreed that any distributions it makes to anyone, including its partners, must be in compliance with applicable securities laws.

Ultimately, we anticipate that with the sale of the units and the formation of the Pest and Termite Control Services Division, we will no longer operate solely through our traditional business segments. In the long term, we expect the Pest and Termite Control Services Division to become our dominant operation. Thus, embarking upon this new strategy will represent a fundamental shift in the nature and focus of our business.

We are currently exploring avenues towards effecting initial acquisitions to be financed with a combination of equity and debt; however, we cannot assure you that these efforts will result in the successful implementation of our new Pest and Termite Control Services Division.

Interests of Certain Persons in the Transaction (page 43)

In considering our Board of Directors' recommendation to approve the Transaction, you should be aware that a number of our directors and executive officers have interests in the Transaction that are different from, or in addition to, your interests as a shareholder. These interests include:

The terms of the Transaction contemplate that: (i) our Chairman, Michael D. Herman, will be permitted to register for resale the shares of our common stock owned by him; and (ii) if Proposal 5 is approved, 3 of our current directors, Arnold Heggstad, Ph.D., Gerard P. Laheney and Steven P. Oppenheim, will be permitted to register for resale the shares of our common stock underlying the options to purchase shares of our common stock owned by them, along with, and to the same extent as, the shares of our common stock being acquired by (and the shares of our common stock underlying the warrants being acquired by) Coconut Palm.

Our President and Chief Executive Officer, James E. Laurent, our corporate Secretary and Chief Financial Officer, Synnott B. Durham, and our Vice President of Operations, Henry A. Budde, will each be entitled to enter into an employment agreement with us, which, by its terms, will be effective upon, and only upon, the closing of the Transaction.

Nominations of Specified Directors to our Board of Directors and Additions to our Management Team (page 33)

As a result of Coconut Palm's desire that it be provided with sufficient ability to monitor and protect its investment in our company, Coconut Palm has nominated, and our Board of Directors has approved the nominations of, Richard C. Rochon and Mario B. Ferrari to our Board of Directors, as Chairman and Vice Chairman, respectively, upon, and only upon, the closing of the Transaction. The remaining nominees presented for election consist of incumbents. We have also agreed, provided our shareholders vote in favor of expanding our Board of Directors from 5 to 7 members, to allow Coconut Palm to nominate 1 additional director to fill the vacancy on our Board of Directors. In addition, if Steven P. Oppenheim, who is one of the director nominees, is elected by our shareholders at the Annual Meeting, he will resign from our Board of Directors upon the closing of the Transaction, and Coconut Palm will have the right to nominate an additional director to fill the vacancy created by Mr. Oppenheim's resignation. Each of the nominees will be elected by a majority vote of our Board of Directors within 30 days of the creation of each of the respective vacancies, as provided by our bylaws.

In addition, John J. Hayes will become our President and Chief Executive Officer, and Donald K. Karnes and David M. Slott will become executive officers of our newly created Pest and Termite Control Services Division after the closing of the Transaction. Messrs. Hayes, Karnes and Slott will serve under the terms of employment agreements they have entered into with us which, by their terms, will be effective upon, and only upon, the closing

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of the Transaction. We anticipate the aggregate compensation for this management team will be approximately \$975,000 in annual salary plus options to purchase 500,000 shares of our common stock at an exercise price of \$5.00 per share, which such options will be granted outside our stock option plan. Messrs. Hayes, Karnes and Slott will also be entitled to participate in our equity-based compensation plans and shall be entitled to other employee benefits to the same extent as our other similarly situated senior executives participate after the closing of the Transaction.

Registration Rights (page 47)

The purchase agreement provides Coconut Palm with specified registration rights under which we have agreed to file a registration statement to register the resale of each of the shares of common stock being issued to Coconut Palm, as well as the shares of common stock underlying the warrants being issued to Coconut Palm, in the Transaction.

We have agreed that we will file the registration statement with the Securities and Exchange Commission as soon as practicable, but not later than 60 days after the closing of the Transaction. We have further agreed to use our reasonable best efforts to cause this registration statement to become effective within 60 days of its filing with the Securities and Exchange Commission.

Additional Arrangements (page 44)

Covenants in the purchase agreement will require us to pursue specified proposed strategies in order to utilize the investment of Coconut Palm to begin our entry into the pest and termite control services industry. These strategies include the following:

Diversifying our operations into the pest and termite control services sector;

Targeting potential acquisitions, or initial acquisitions, of pest and termite control services companies in the United States and its territories from which we may form the Pest and Termite Control Services Division;

Financing the growth of our new Pest and Termite Control Services Division by accessing the equity and debt capital markets to the extent access to such markets is deemed to be favorable by our Board of Directors; and

Divesting ourselves of certain non-core assets acquired in connection with our purchase of: (i) Percipia, Inc. and its wholly-owned subsidiary Percipia Networks, Inc.; and (ii) the assets of Telecom FM, at a purchase price equal to the amount we paid for such assets plus the amount of any intercompany debt incurred and advances made in connection with such purchases.

We anticipate that the initial acquisition(s) will occur after we complete the sale of the units and will be financed with a combination of equity and debt, with \$1,000,000 of our existing cash and the investment made by Coconut Palm in the Transaction being dedicated to acquisitions in furtherance of these strategies and objectives and costs reasonably incidental to the furtherance of these strategies, including the new management team to be formed and led by Messrs. Hayes, Karnes and Slott.

We have also agreed, upon the closing of the Transaction, to enter into a 5 year management services agreement with an affiliate of Coconut Palm, RPC Financial Advisors, LLC (RPC), to provide management services for our Pest and Termite Control Services Division, pursuant to which we will pay a management fee during the first year of an amount equal to 1/16 times the aggregate purchase price paid for the units by Coconut Palm. Following the first year and thereafter, the management fee will be equal to 1% of the gross revenues from operations of our new Pest and Termite Control Services Division. Certain officers and directors of RPC will also serve as members of our Board of Directors upon the closing of the Transaction.

In connection with the purchase agreement, Coconut Palm and our Chairman, Michael D. Herman, who beneficially owns approximately 51% of our currently outstanding common stock, entered into a voting agreement,

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dated November 17, 2004. Pursuant to the terms of the voting agreement, Mr. Herman agreed to vote his beneficially owned shares of common stock in favor of the issuance and sale of the units to Coconut Palm at the Annual Meeting and to grant Coconut Palm an irrevocable proxy to vote such shares of common stock: (i) in favor of the issuance and sale of the units to Coconut Palm, as contemplated by the purchase agreement; and (ii) against any actions or approval that could compete with or could serve to materially interfere with, delay, discourage adversely or inhibit the timely consummation of the issuance and sale of the units to Coconut Palm, as contemplated by the purchase agreement. The voting agreement also prohibits Mr. Herman from selling or transferring the shares of our common stock beneficially owned by him other than in certain permitted circumstances. The voting agreement terminates upon the earlier to occur of: (i) the consummation of the transactions contemplated by the purchase agreement; (ii) any termination of the purchase agreement in accordance with its terms; or (iii) the withdrawal by our Board of Directors of its approval of the transactions contemplated by the purchase agreement pursuant to Section 8(n) of the purchase agreement.

Approval of Options to 3 of our Current Directors (page 36)

On August 5, 2004, our Board of Directors approved the grant of an aggregate of 60,000 options to purchase shares of our common stock to Arnold Heggstad, Ph.D., Gerard P. Laheney and Steven P. Oppenheim, each of whom is a current member of our Board of Directors; however, the rules of the American Stock Exchange require that our shareholders approve the issuance of such options, because the options will be issued outside of our existing stock option plan.

Interdependence of Proposals

While the proposals in this proxy statement are being listed separately for purposes of voting, Proposals 1, 2 and 3 are all interdependent. Accordingly, obtaining the requisite shareholder approval for each such proposal is a condition precedent to the effectiveness of the other such proposals. In addition that portion of Proposal 4 relating to the election of Messrs. Rochon and Ferrari to our Board of Directors, the resignation of Mr. Oppenheim from our Board of Directors and the filling of the 2 vacancies by Coconut Palm nominees (including the 1 additional newly created vacancy if Proposal 2 is approved by our shareholders, and the vacancy created by Mr. Oppenheim's resignation), are each contingent upon the closing of the Transaction. If the Transaction does not close: (i) the election of Messrs. Rochon and Ferrari to our Board of Directors will not become effective; (ii) Mr. Oppenheim will not resign from our Board of Directors; and (iii) Coconut Palm will not fill any vacancies on our Board of Directors. That portion of Proposal 4 relating to the election of Messrs. Herman, Heggstad, Laurent and Oppenheim, Proposal 5 and Proposal 6 are each independent of the other proposals in this proxy statement and will become effective, if approved, irrespective of whether our shareholders approve the Transaction.

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VOTING SECURITIES

Date; Time; Venue

The Annual Meeting of Shareholders (the Annual Meeting) will be held on February 4, 2005, at 10:00 am, local time, at the Embassy Suites, 1100 SE 17th St., Fort Lauderdale, FL, 33316.

Quorum

The presence, in person or by proxy, of the holders of shares representing a majority of the outstanding shares of our common stock will constitute a quorum.

Shareholder Vote Necessary to Approve Proposals

The affirmative vote of the majority of the votes cast by the holders of our common stock present or represented by proxy and voting on the matter is required to approve: (i) the issuance of shares of our common stock in connection with our proposed sale of up to 5,000,000 units to Coconut Palm, as described in Proposal 1; (ii) an increase in the size of our Board of Directors from 5 to 7 members, with the 1 additional newly created vacancy to be filled by a Coconut Palm nominee and elected by a majority vote of our Board of Directors within 30 days of the Annual Meeting, as described in Proposal 2; (iii) the issuance of an aggregate of 60,000 options to purchase shares of our common stock to 3 of our current directors outside of our existing stock option plan, as described in Proposal 5; and (iv) the approval of our 2004 Stock Incentive Plan, as described in Proposal 6.

The affirmative vote of the holders of a majority of the shares of our common stock entitled to vote on the matter is required to approve the amendments to our Articles of Incorporation, as described in Proposal 3.

The affirmative vote of a plurality of the votes cast by our shareholders is required to approve the election of the 6 nominees to our Board of Directors, as described in Proposal 4.

If any other matters should properly come before the Annual Meeting, proxies will be voted on these other matters in accordance with the judgment of the persons voting the proxies.

While the proposals in this proxy statement are being listed separately for purposes of voting, Proposals 1, 2 and 3 are all interdependent. Accordingly, obtaining the requisite shareholder approval for each such proposal is a condition precedent to the effectiveness of the other such proposals. In addition, that portion of Proposal 4 relating to the election of Messrs. Rochon and Ferrari to our Board of Directors, the resignation of Mr. Oppenheim from our Board of Directors and the filling of the 2 vacancies by Coconut Palm nominees (including the 1 additional newly created vacancy if Proposal 2 is approved by our shareholders, and the vacancy created by Mr. Oppenheim's resignation), are each contingent upon the closing of the Transaction. If the Transaction does not close: (i) the election of Messrs. Rochon and Ferrari to our Board of Directors will not become effective; (ii) Mr. Oppenheim will not resign from our Board of Directors; and (iii) Coconut Palm will not fill any vacancies on our Board of Directors. That portion of Proposal 4 relating to the election of Messrs. Herman, Heggstad, Laurent and Oppenheim, Proposal 5 and Proposal 6 are each independent of the other proposals in this proxy statement and will become effective, if approved, irrespective of whether our shareholders approve the Transaction.

Proxy and Voting Mechanics

If you hold of record shares of our common stock at the close of business on [January 7, 2005], the record date, you are entitled to vote at the Annual Meeting. Each share of our common stock is entitled to one vote upon all matters to be acted upon at the Annual Meeting. As of the record date, we had issued and outstanding [4,014,870] shares of common stock.

Abstentions are considered as shares present and entitled to vote for purposes of determining the outcome of any matter submitted to the shareholders for a vote, but are not counted as votes cast for or against any matter. The inspector of elections will treat shares referred to as broker or nominee non-votes (shares held by

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brokers or nominees as to which instructions have not been received from the beneficial owners or persons entitled to vote and the broker or nominee does not have discretionary voting power on a particular matter) as shares that are present and entitled to vote for purposes of determining the presence of a quorum. For purposes of determining the outcome on proposals as to which the proxies reflect broker or nominee non-votes, shares represented by these proxies will be treated as not present and not entitled to vote on that subject matter. Accordingly, these shares would not be considered by the inspectors as shares entitled to vote on that subject matter and therefore would not be considered by the inspector when counting votes cast on the matter.

Your vote is important. Accordingly, you are urged to sign, date and return the accompanying proxy card whether or not you plan to attend the Annual Meeting. If you do attend, you may vote by ballot at the Annual Meeting, which will have the effect of canceling any proxy previously given.

If the enclosed proxy is properly signed, dated and returned, the shares represented by the proxy will be voted in accordance with the instructions on the proxy card. If no instructions are indicated, the shares represented by the proxy will be voted in the following manner:

- (i) FOR the proposal to issue up to 5,000,000 shares of our common stock and up to an additional 10,000,000 shares of common stock upon the exercise of warrants issued to Coconut Palm;
- (ii) FOR the proposal to increase the size of our Board of Directors from 5 to 7 members;
- (iii) FOR the proposal to approve the amendments to our Articles of Incorporation;
- (iv) FOR the election of each of the nominees for director;
- (v) FOR the proposal to grant an aggregate of 60,000 options to 3 of our current directors outside of our existing stock option plan; and
- (vi) FOR the proposal to approve our 2004 Stock Incentive Plan.

If any other matters should properly come before the Annual Meeting, proxies will be voted on these other matters in accordance with the judgment of the persons voting the proxies. Discretionary authority to vote on such matters is conferred only by the granting of these proxies.

Any shareholder giving a proxy may revoke it by written notice to our corporate Secretary at the address provided above at any time before it is exercised. Attendance at the Annual Meeting will not have the effect of revoking the proxy unless this written notice is given or unless the shareholder votes by ballot at the Annual Meeting.

Costs of Proxy Solicitation

We will bear the cost of preparing, printing, assembling and mailing all proxy materials that may be sent to shareholders in connection with this solicitation. Arrangements will also be made with brokerage houses, other custodians, nominees and fiduciaries, to forward soliciting material to the beneficial owners of shares of our common stock held by these persons. We will reimburse these persons for reasonable out-of-pocket expenses incurred by them. In addition to the solicitation of proxies by use of the mails, our officers and regular employees may solicit proxies without additional compensation by telephone or telegraph. We do not expect to pay any compensation for the solicitation of proxies.

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PROPOSAL NO. 1

Proposed Sale of up to 5,000,000 Units to Coconut Palm Capital Investors II, Ltd.

Background

We have been investigating strategic alternatives to our business that would provide predictable, recurring revenue for our shareholders since January 2004. As a part of this new strategy, we have explored and analyzed the possibility of entering into different industries, and on September 2, 2004, our Chairman, Michael D. Herman, and Mario B. Ferrari, an affiliate of Coconut Palm Capital Investors II, Ltd. (Coconut Palm), held an introductory telephonic conversation, during which Mr. Herman detailed our company's history and current strategic position. On September 3, 2004, Messrs. Herman and Ferrari held a follow-up telephonic discussion to set up a potential meeting between the parties, and on September 8, 2004, Messrs. Herman and Ferrari held a telephonic discussion to setup the meeting for September 16, 2004.

In mid September, Richard C. Rochon, also an affiliate of Coconut Palm, held general discussions with John J. Hayes, Donald K. Karnes and David M. Slott regarding a potential investment in our company. Each of Messrs. Hayes, Karnes and Slott had a prior relationship working with Mr. Rochon when he served as President of Huizenga Holdings, Inc., a management and holding company, and also were investors in an additional transaction with Mr. Rochon that was completed since such time.

On September 16, 2004, Messrs. Rochon and Ferrari met with our Chief Financial Officer, Synnott B. Durham and our Board of Directors, including Mr. Herman, Gerard P. Laheney, James E. Laurent (who is also our President and Chief Executive Officer) and Steven P. Oppenheim. Our Board of Directors provided a background and history of our company in a general discussion. Messrs. Rochon and Ferrari then detailed an investment philosophy and interest in a potential control investment to be made in our company by Coconut Palm. Messrs. Rochon and Ferrari also introduced the concept of introducing a new services division to our company, which would provide stabilized earnings and recurring revenue to our existing lines of business.

On September 17, 2004, Mr. Ferrari met with Mr. Herman to detail a structure for the proposed investment, including an overview of Coconut Palm's investment philosophy. Messrs. Herman and Ferrari discussed a potential equity investment in our company in the range of approximately \$15,000,000, and also discussed the potential share price, approximately \$5.00, at which Coconut Palm would be interested in an investment. Mr. Herman stated that given the recent market prices, an investment at \$5.00 was a price that would create value for our shareholders. In addition, Mr. Herman and Mr. Ferrari discussed a potential management services agreement and the possibility of expanding our Board of Directors from 5 to 7 members. On September 18, 2004, Mr. Ferrari and Mr. Herman held a telephonic discussion, which detailed the timing and framework for both parties' moving forward.

On September 19, 2004, Mr. Ferrari and Mr. Herman held a telephonic discussion and a preliminary term sheet was prepared for Mr. Herman's review. The general parameters of the term sheet called for Coconut Palm to make an equity investment of between \$10,000,000 to \$25,000,000 in convertible preferred stock with an initial investment at \$5.00 per share with attached warrants that would be exercisable at ranging prices. The term sheet was then presented for review by our Board of Directors and legal counsel.

On September 20, 2004, Mr. Ferrari and Mr. Herman, together with our legal counsel, held a telephonic discussion to review the proposed term sheet and structure of the investment. Mr. Herman stated that we were more interested in a combination of convertible preferred and common stock investment. Our legal counsel stated that they would prepare an issues list for Coconut Palm's review. On September 23, 2004, Messrs. Rochon and Ferrari met with Messrs. Karnes, Slott and Hayes regarding potential opportunities with our company. On October 3, 2004,

Messrs. Ferrari and Herman held telephonic discussions to further review the strategy, terms and timeline.

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On October 7, 2004, Messrs. Rochon and Ferrari met with Mr. Laurent and Mr. Durham to discuss the strategy for entering the pest and termite control services industry. Messrs. Laurent and Durham presented an overview of the history of our company during their tenures of approximately 26 and 25 years, respectively. They also provided a context for Mr. Herman's involvement as an investor since November 2003 and the transition of the company since the leadership of its former controlling shareholder. Also on October 7, 2004, Mr. Ferrari and Mr. Herman met with Messrs. Karnes, Slott and Hayes for dinner to discuss possible opportunities to work together.

On October 8, 2004, Mr. Herman met with Mr. Ferrari and further discussed the terms and conditions for a proposed investment structure with an initial purchase price of \$5.00 and two tranches of warrants that would be exercisable at \$6.00 and \$7.00. A management structure and fee was also discussed, and Mr. Herman indicated that he would remain on our Board of Directors, and discussed allowing Coconut Palm to nominate 4 members to our Board of Directors. On October 11, 2004, Mr. Herman held a telephonic discussion with Mr. Ferrari and arranged an additional meeting.

On October 12, 2004, a term sheet was presented to Mr. Herman reflecting the latest negotiations. On October 13, 2004, Messrs. Rochon and Ferrari met with Mr. Herman to discuss the investment and held further discussions with lawyers and accountants regarding the investment process. On October 19, 2004, our Board of Directors held a meeting and approved the term sheet as proposed by Coconut Palm. On October 20, 2004, Mr. Herman held a meeting with Messrs. Ferrari, Durham and Oppenheim and addressed Messrs. Karnes, Slott and Hayes with the proposed strategy and timeline required to execute the strategy.

On November 3, 2004, our Board of Directors held a telephonic meeting to address and present the purchase agreement proposed by Coconut Palm. In addition to the economic terms of the purchase agreement, our Board of Directors discussed registration rights for the common stock underlying the units, and agreed that we would be required to file a registration statement with the Securities and Exchange Commission registering such shares of our common stock not later than 60 days after the closing of the transaction and would use our reasonable best efforts to cause this registration statement to become effective within 60 days of its filing with the Securities and Exchange Commission. Our Board of Directors also discussed whether the Mr. Herman should enter into a voting agreement under the terms of which he would agree to vote his shares of our common stock in favor of the transaction. Mr. Herman agreed to enter into such voting agreement. During the meeting we also confirmed that we had to obtain shareholder approval of the transaction as the total amount of new shares of common stock would be more than 20% of our existing outstanding shares of common stock.

On November 15, 2004, Paul D. DeStefanis, P.A. d/b/a Advanced Business Valuations made a presentation to our officers and Audit Committee setting forth its financial analyses regarding the transaction. On November 16, 2004, Advanced Business Valuations made a subsequent presentation to our Board of Directors and rendered its oral opinion that, as of such date, based upon and subject to the assumptions made, matters considered, and limitations on its review as set forth in the opinion, the purchase price is fair, from a financial point of view, to our shareholders. Subsequently, Advanced Business Valuations delivered its written opinion.

Also on November 16, 2004, our legal counsel and management reviewed with our Board of Directors the remaining business issues and obtained Board of Director guidance on these issues. Our legal counsel also reviewed with our Board of Directors its fiduciary duties in connection with the approval of the proposed transaction. After the discussion, our Board of Directors determined that the proposed transaction was in our best interests and the best interests of our shareholders, and authorized and approved the transaction and recommended it be submitted to our shareholders for their approval. In connection with the transaction, our Board of Directors discussed the proposed increase in the size of our Board of Directors to from 5 to 7 members, and determined that such increase was in our best interests and the best interests of our shareholders and recommended that the proposed increase be submitted to our shareholders, in accordance with our Articles of Incorporation and bylaws. Our Board of Directors also

determined that in light of Coconut Palm's requirement that this be a condition for it to enter into the purchase agreement, and in light of the experience, qualifications, resources and skills they possessed, the election of the two individuals nominated by Coconut Palm to our Board of Directors was in our best interests and the best interests of our shareholders. Accordingly, our Board of Directors authorized and approved the nomination of Richard C. Rochon and Mario B. Ferrari and recommended the nominees be submitted for election by our shareholders. Our Board of Directors also reviewed the proposed amendments to our Articles of Incorporation which would change our corporate name to Sunair, Inc., allow us to engage in any lawful business and increase the number of our

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authorized shares of capital stock to 108,000,000 shares, of which 100,000,000 shares will be common stock and 8,000,000 shares will be preferred stock. Our Board of Directors approved these amendments and recommended they be submitted to our shareholders for approval. In addition, our Board of Directors confirmed the grants of an aggregate of 60,000 options to purchase shares of our common stock outside of our existing stock option plan to Arnold Heggstad, Ph.D., Gerard P. Laheney and Steven P. Oppenheim, each of whom is a current member of our Board of Directors, which were approved by our Board of Directors on August 5, 2004, and recommended that such grants be submitted to our shareholders for approval. All of our directors attended this meeting.

Shift in Focus of Business

If we close the transaction, we intend to use the proceeds from the sale of the units to fund initial acquisitions that have operations in the pest and termite control services sector and to form a new Pest and Termite Control Services Division. Ultimately, we anticipate that with the sale of the units and the formation of our new Pest and Termite Control Services Division, we will no longer operate solely through our traditional business segments. Furthermore, as we are able to grow our new Pest and Termite Control Services Division through acquisitions and, eventually through internal organic growth, it is contemplated that this new segment will become our dominant operation. Accordingly, if we are successful in implementing this strategy, it will represent a fundamental shift in the nature of our business.

In connection with our change in business strategy, and in accordance with the purchase agreement, we also agreed to use our best efforts to enter into a definitive agreement as soon as practicable to divest ourselves of certain non-core assets acquired in connection with our purchase of: (i) Percipia, Inc. and its wholly-owned subsidiary Percipia Networks, Inc.; and (ii) the assets of Telecom FM, at a purchase price equal to the amount we paid for such assets plus the amount of any intercompany debt incurred and advances made in connection with such purchases. The non-core assets are currently held in separate wholly-owned subsidiaries.

American Stock Exchange Listing

Our common stock is listed on the American Stock Exchange. The American Stock Exchange has established rules of corporate governance that must be followed by all issuers whose securities are listed on the American Stock Exchange. Under these rules, we are required to obtain shareholder approval prior to the issuance of securities in connection with a transaction other than a public offering involving:

1) the sale, issuance, or potential issuance by us of our common stock (or securities convertible into our common stock) at a price less than the greater of book or market value which together with sales by our officers, directors or principal shareholders equals 20% or more of presently outstanding common stock;

2) the sale, issuance, or potential issuance by us of our common stock (or securities convertible into our common stock) equal to 20% or more of our presently outstanding common stock for less than the greater of book or market value of the common stock; or

3) any plan of acquisition, merger or consolidation, the net effect of which is that we are acquired by an unlisted company, even if we are the survivor.

In applying these rules, the American Stock Exchange considers all relevant factors, including the proportionate amount of the securities to be issued, changes in ownership or management, the size of the companies, and the nature of the businesses. These rules are referred to in this proxy statement as the 20% Rule.

In light of the requirements of the 20% Rule, we are requesting that the shareholders approve the issuance by us to Coconut Palm of up to 5,000,000 units at a purchase price of \$5.00 per unit consisting of: (i) one share of our common

stock; (ii) a warrant to purchase one additional share of our common stock, at an exercise price of \$6.00 per share, which will be immediately exercisable and will expire after three years; and (iii) a warrant to purchase one additional share of our common stock, at an exercise price of \$7.00 per share, which will be immediately exercisable and will expire after five years, in accordance with the terms of the purchase agreement.

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Section 607.0902 (Control Share Acquisitions Statute)

Section 607.0902 of the Florida Business Corporation Act, or the control-share acquisition statute, regulates the acquisition of control of any issuing public corporation, which is defined in the control-share acquisition statute as a corporation that has more than 100 shareholders and a substantial nexus to Florida. Under the section, control shares acquired in a control-share acquisition have voting rights only if, and to the extent, granted in a resolution of the shareholders of the corporation approved by (1) a majority of all the votes entitled to be cast by each class or series entitled to vote on the proposed control-share acquisition and (2) a majority of all shares of each class or series entitled to vote separately on the proposal, excluding all interested shares. Interested shares are shares that are owned by the acquiring person or persons, each officer of the corporation and each employee of the corporation who is also a director of the corporation.

However, the restrictions of Section 607.0902 do not apply where the Board of Directors of the corporation issuing the shares approves of the transaction and thereby removes the acquisition of the shares from the definition of control-share acquisition, which takes the acquisition out of the purview of the section. This board approval must come before the control-share acquisition occurs. On November 16, 2004, our Board of Directors unanimously determined that the transaction was in our best interests and in the best interests of our shareholders, and authorized and approved the transaction. Accordingly, the transaction, which would constitute a control-share acquisition under Section 607.0902, has received board approval and, as a result, the restrictions of Section 607.0902 do not apply to the transaction.

No Dissenters Rights of Appraisal

Appraisal rights, also known as dissenters rights, allow shareholders who object to a major corporate transaction to elect to receive the fair value of their shares in cash rather than continue as shareholders of the corporation. Under Section 607.1302 of the Florida Business Corporation Act, appraisal rights are accorded to shareholders in substantial corporate matters such as: (i) a merger to which a corporation is a party if shareholder approval is required; (ii) a share exchange to which a corporation is a party as the corporation whose shares will be acquired if the shareholder is entitled to vote on the exchange; (iii) a disposition of assets other than in regular course of business if the shareholder is entitled to vote on the disposition; (iv) any amendment to the articles of incorporation, merger, share exchange, or disposition of assets other than in regular course of business to the extent provided by the articles of incorporation, bylaws, or a resolution of the board of directors; or (v) with regard to certain classes of shares issued prior to October 1, 2003, any amendment to a corporation's articles of incorporation that would adversely affect certain enumerated shareholder rights, if the shareholder is entitled to vote on the amendment.

The restrictions of Section 607.1302 do not apply with respect to the transaction, because the sale of shares of our common stock and warrants to purchase shares of our common stock are out of the purview of the section. Accordingly, under Florida law, our shareholders will not have the opportunity to dissent from the transaction or to receive an agreed or judicially appraised value for their shares of common stock.

Recommendation of our Board of Directors and Reasons for the Transaction

We have been investigating strategic alternatives to our business since January 2004. We believe that, notwithstanding the fact that we have enjoyed the benefits of experienced and qualified employees and executives as well as periods of positive cash flow, our business has not been growing at a rate we believe it could achieve and is generally in need of a new or additional industry focus as a catalyst for growth. As a part of this new strategy, we explored and analyzed the possibility of being purchased by a strategic buyer or, alternatively, whether it was best to sell certain non-core assets acquired in connection with our purchase of: (i) Percipia, Inc. and its wholly-owned

subsidiary Percipia Networks, Inc.; and (ii) the assets of Telecom FM. Coconut Palm then approached us to discuss our entry into another line of business, the pest and termite control services industry, which would be driven initially by Coconut Palm's investment.

When we were approached by Coconut Palm, we believed the best interests of our shareholders required us to pursue an opportunity for investment from Coconut Palm and to use the cash resources as well as the experience and other resources Coconut Palm could offer to pursue this strategic alternative. In making this determination, we

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considered that Richard C. Rochon had, in our opinion, a positive history of investing in and improving companies. Although we cannot assure you pursuing the strategic alternative in the pest and termite control services industry will ultimately benefit us and lead to increased profitability, we believe undertaking this aggressive growth strategy is in our best interests at this point in our company's life.

At its meeting on November 16, 2004, our Board of Directors determined that the proposed transaction is in our best interests and the best interests of our shareholders. In formulating its decision to pursue the pest and termite control services industry, our Board of Directors reviewed the characteristics of the pest and termite control service sector with respect to its key operating characteristics, competitive landscape, comparable transactions, and comparable companies. Based on this review, our Board of Directors made the following observations:

The pest and termite control services industry, a highly fragmented industry which is actively consolidating, represents \$6.8 billion in annual revenues distributed among approximately 20,000 firms.

The sector is dominated by a number of large players (e.g. Terminix International, Orkin Pest Control, Ecolab Pest Elimination and others) who together make up a large percentage of the market. The remainder of the market consists of small companies with under \$100 million in sales.

Competition in the market for pest and termite control services is strong, coming mainly from the larger noted companies and thousands of regional and local independently owned firms to homeowners who treat their own pest and termite control problems.

Revenue growth in the sector for the larger companies has been relatively flat in recent years, while the entire market growth rate is approximately 10% per year.

There are significant economies of scale advantages through the consolidation of pest and termite control companies.

There are no publicly listed companies in the United States that are exclusively engaged in the pest and termite control services industry. Paul D. DeStefanis, P.A. d/b/a Advanced Business Valuations reviewed the financial characteristics of several companies in the industrials-diversified commercial services industry, including The ServiceMaster Company, Ecolab, Inc., ABM Industries, and Carlisle Holdings Ltd. Advanced Business Valuations noted that the equity value-to-revenue multiples ranged from 1.04 to 2.23 times, and equity value to earnings multiples ranged from 22.90 to 29.91 times.

Our Board of Directors also based its determination on a number of other factors, including the following:

the presentations delivered by our financial advisor, Paul D. DeStefanis, P.A. d/b/a Advanced Business Valuations, to our Board of Directors on November 15, 2004 and November 16, 2004, and the written opinion of Advanced Business Valuations dated November 16, 2004, addressed to our Board of Directors to the effect that, as of the date of the opinion and based on and subject to the matters set forth in the opinion, the issuance of the units at the price stated in this proxy statement was fair from a financial point of view to us and our shareholders;

the terms of the purchase agreement and the proposed strategies and objectives for implementing our new Pest and Termite Control Services Division, the warrants, the increase in the size of our Board of Directors, the proposed amendments to our Articles of Incorporation, the voting agreement, the management services agreement and the employment agreements to be entered into with Messrs. Hayes, Karnes and, Slott;

our increased cash resources as a result of the cash infusion by Coconut Palm;

the possibility that Messrs. Hayes, Karnes and Slott could successfully implement our new Pest and Termite Control Services Division;

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the potential appreciation in the market value of our common stock due to the involvement of Coconut Palm, the principals of which have positive reputations in the business community as well as our entry into a new line of business and the potential success of that business; and

that, based upon estimates of management, following the consummation of the transaction, we would have sufficient liquidity, including cash flows from its operations, to conduct our new Pest and Termite Control Services Division.

Our Board of Directors also considered a number of potentially negative consequences of the transaction in its deliberations, including:

the potential reduction in our earnings per share due to the dilution of the percentage ownership of the existing holders of the shares of our common stock resulting from the issuance of the shares under the purchase agreement, as well as the issuance of the shares upon exercise of the warrants. Immediately following the transaction, Coconut Palm will beneficially own, collectively, up to 5,000,000 shares of our common stock and will be entitled to purchase up to an additional 10,000,000 shares of our common stock upon exercise of the warrants. If Coconut Palm purchases all 5,000,000 shares of our common stock, Coconut Palm will be entitled, on a fully diluted basis, to acquire up to 79% of our common stock outstanding immediately after the closing of the transaction;

the possible decline in the market price of the shares of our common stock caused by the sale by shareholders of their shares as a result of the perceived risk of dilution of the earnings per share and voting rights of our shareholders;

the possible engagement in short sales by third parties as a result of the possible perceived risk of dilution and decline in the market price of the shares of our common stock;

the fact that Coconut Palm would be purchasing a significant ownership interest which could effectively deter third parties from making an offer to acquire us after the closing of the transaction, which offer could involve a premium stock price or other benefits for shareholders or otherwise prevent changes in control or management of us after the closing of the transaction;

our new Pest and Termite Control Services Division management team may not be able to implement effectively our new pest and termite control services franchise; and

the risk that the benefits sought to be achieved in the transaction, including the successful implementation of our new Pest and Termite Control Services Division, will not be achieved.

This discussion of information and factors considered by our Board of Directors is not intended to be exhaustive but is intended to summarize all material factors considered by our Board of Directors. In view of the wide variety of factors considered by our Board of Directors, our Board of Directors did not find it practicable to quantify or otherwise assign relative weights to the specific factors considered. However, after taking into account all of the factors set forth above, our Board of Directors has determined that the transaction is in our best interests and the best interests of our shareholders and that we should enter into the transaction.

Opinion of Financial Advisor to the Company

Our Board of Directors retained Paul D. DeStefanis, P.A. d/b/a Advanced Business Valuations to express an opinion as to the fairness of the transaction. Advanced Business Valuations has been retained to render an opinion as to whether, on the date of such opinion, the transaction is fair, from a financial point of view, to our shareholders. For purposes of the transaction, the purchase price is comprised of: (i) \$4.31 attributable to the shares of our common

stock or the share consideration; (ii) \$.032 attributable to the warrants to purchase one additional share of our common stock, at an exercise price of \$6.00 per share, which will be immediately exercisable and will expire after three years (the First Tranche Warrants); and (iii) \$.037 attributable to the warrants to purchase one

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additional share of our common stock, at an exercise price of \$7.00 per share, which will be immediately exercisable and will expire after five years (the Second Tranche Warrants).

On November 15, 2004, Advanced Business Valuations made a presentation to our officers and Audit Committee setting forth its financial analyses regarding the transaction. On November 16, 2004, Advanced Business Valuations made a subsequent presentation to our Board of Directors and rendered its oral opinion that, as of such date, based upon and subject to the assumptions made, matters considered, and limitations on its review as set forth in the opinion, the purchase price is fair, from a financial point of view, to our shareholders. Subsequently, Advanced Business Valuations delivered its written opinion.

The full text of the written opinion of Advanced Business Valuations, dated as of November 16, 2004, is attached as Annex A and is incorporated by reference into this proxy statement. Sunair and Advanced Business Valuations urge you to read the Advanced Business Valuations opinion carefully.

No limitations were imposed by us on the scope of Advanced Business Valuations' investigation or the procedures to be followed by Advanced Business Valuations in rendering its opinion. The Advanced Business Valuations opinion was for the use and benefit of our Board of Directors in connection with its consideration of the transaction and was not intended to be and does not constitute a recommendation to any of our shareholders as to how that shareholder should vote with respect to the transaction. Advanced Business Valuations was not requested to opine as to, and its opinion does not address, our underlying business decision to proceed with or effect the transaction. Further, Advanced Business Valuations was not asked to consider, and its opinion does not address, the relative merits of the transaction as compared to any alternative business strategy that might exist for us. Advanced Business Valuations was not engaged to seek alternatives to the transaction that might exist for us.

In arriving at its opinion, Advanced Business Valuations took into account an assessment of general economic, market and financial conditions as well as its experience in connection with similar transactions and securities valuations generally and, among other things: (i) reviewed a draft of the purchase agreement between us and Coconut Palm; (ii) reviewed publicly available financial information and other data with respect to our company, including the Annual Reports on Form 10-KSB for the years ended September 30, 2003, 2002 and 2001, Quarterly Reports on Form 10-QSB for the quarters ended December 31, 2002, March 31, 2003, June 30, 2003, December 31, 2003, March 31, 2004, and June 30, 2004, and all Forms 8-K filed in the last eighteen month period ended October 31, 2004; (iii) reviewed and analyzed our unaudited financial statements for the year ended September 30, 2004; (iv) reviewed and analyzed the transaction's financial impact on our book value and impact on our common shares outstanding; (v) reviewed and analyzed certain information related to the pest and termite control sector of the professional services industry; (vi) reviewed certain pest and termite control companies audited financial and other related public filings; (vii) considered our historical financial results and present financial condition; (viii) reviewed certain publicly available information concerning the trading of, and the trading market for, our common stock; (ix) reviewed and analyzed certain financial characteristics of companies that were deemed to have characteristics comparable to ours; (x) reviewed and analyzed certain financial characteristics of target companies in transactions where that target company was deemed to have characteristics comparable to ours; (xi) reviewed and analyzed our free cash flows and prepared discounted cash flow analysis; (xii) reviewed and analyzed our adjusted net book value; (xiii) reviewed and analyzed the premium implied by the share consideration; (xiv) reviewed and discussed with representatives of our management team certain financial and operating information furnished by them, including financial analyses with respect to our business and operations; (xv) inquired about and discussed the transaction and other matters related to the transaction with our management and Board of Directors; and (xvi) performed such other analyses and examinations as were deemed appropriate.

In arriving at its opinion, Advanced Business Valuations relied upon and assumed the accuracy and completeness of all of the financial and other information that was used without assuming any responsibility for any independent

verification of any such information and has further relied upon the assurances of our management team that it is not aware of any facts or circumstances that would make any such information inaccurate or misleading. Advanced Business Valuations did make a physical inspection of our properties and facilities in our Fort Lauderdale offices, however, Advanced Business Valuations did not make or obtain any evaluations or appraisals of our assets and liabilities (contingent or otherwise). Advanced Business Valuations assumed that the transaction will be consummated in a manner that complies in all respects with the applicable provisions of the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, and all other applicable federal and state

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statutes, rules and regulations. Advanced Business Valuations assumed that the transaction will be consummated substantially in accordance with the terms set forth in the draft purchase agreement, without any further amendments to the draft purchase agreement, and without our waiver of any of the conditions to any obligations or in the alternative that any of these amendments, revisions or waivers thereto will not be detrimental to the our shareholders.

Advanced Business Valuations' opinion is based upon market, economic and other conditions as they existed on, and could be evaluated as of, November 16, 2004. Accordingly, although subsequent developments may affect its opinion, Advanced Business Valuations has not assumed any obligation to update, review or reaffirm its opinion.

The estimates contained in Advanced Business Valuations' analyses and the ranges of valuations resulting from any particular analysis are not necessarily indicative of actual values or future results, which may be significantly more or less favorable than those suggested by such analyses. In addition, analyses relating to the value of businesses or securities do not necessarily purport to be appraisals or to reflect the prices at which businesses or securities actually may be sold. Accordingly, Advanced Business Valuations' analyses and estimates are inherently subject to substantial uncertainty.

Each of the analyses conducted by Advanced Business Valuations was carried out in order to provide a different perspective on the transaction, and to enhance the total mix of information available. Advanced Business Valuations did not form a conclusion as to whether any individual analysis, considered in isolation, supported or failed to support an opinion as to the fairness, from a financial point of view, of the purchase price to our shareholders. Advanced Business Valuations did not place any particular reliance or weight on any individual analysis, but instead concluded that its analyses, taken as a whole, supported its determination. Accordingly, Advanced Business Valuations believes that its analyses must be considered as a whole and that selecting portions of its analyses or the factors it considered, without considering all analyses and factors collectively, could create an incomplete and misleading view of the process underlying the analyses performed by Advanced Business Valuations in connection with the preparation of its opinion.

The financial reviews and analyses include information presented in tabular format. In order to fully understand Advanced Business Valuations' financial review and analyses, the tables must be read together with the text presented. The tables alone are not a complete description of the financial review and analyses and considering the tables alone could create a misleading or incomplete view of Advanced Business Valuations' financial review and analyses.

Further, the summary of Advanced Business Valuations' analyses described below is not a complete description of the analyses underlying Advanced Business Valuations' opinion. The preparation of a fairness opinion is a complex process involving various determinations as to the most appropriate and relevant methods of financial analysis and the application of those methods to the particular circumstances and, therefore, a fairness opinion is not readily susceptible to partial analysis or summary description. In arriving at its opinion, Advanced Business Valuations made qualitative judgments as to the relevance of each analysis and factors that it considered.

Pro Forma Review. Advanced Business Valuations analyzed the pro forma impact of the transaction (assuming 3,000,000 units acquired) to our book value and securities ownership. Advanced Business Valuations noted that our net book value per share would increase from \$4.22 per share to \$4.55 per share (excluding the additional proceeds from the exercise of the First Tranche Warrants and Second Tranche Warrants) and Coconut Palm would own approximately 43% of our company. Advanced Business Valuations also noted that if Coconut Palm acquires 3,000,000 units in the transaction and if both the First Tranche Warrants and Second Tranche Warrants are exercised, then our net book value per share would increase from \$4.22 per share to \$5.45 per share, and Coconut Palm would own approximately 69% of our company.

Pest and Termite Control Sector Review. Advanced Business Valuations reviewed the characteristics of the pest and termite control sector with respect to its key operating characteristics, competitive landscape, comparable transactions, and comparable companies. Based on this review, Advanced Business Valuations made the following observations:

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The pest and termite control services industry, a highly fragmented industry which is actively consolidating, represents \$6.8 billion in annual revenues distributed among approximately 20,000 firms.

The sector is dominated by a number of large players (e.g. Terminix International, Orkin Pest Control, Ecolab Pest Elimination and others) who together make up a large percentage of the market. The remainder of the market consists of small companies with under \$100 million in sales.

Competition in the market for pest and termite control services is strong, coming mainly from the larger noted companies and thousands of regional and local independently owned firms to homeowners who treat their own pest and termite control problems.

Revenue growth in the sector for the larger companies has been relatively flat in recent years, while the entire market growth rate is approximately 10% per year.

There are significant economies of scale advantages through the consolidation of pest and termite control companies.

There are no publicly listed companies in the United States that are exclusively engaged in the pest and termite control services industry. Paul D. DeStefanis, P.A. d/b/a Advanced Business Valuations reviewed the financial characteristics of several companies in the industrials-diversified commercial services industry, including The ServiceMaster Company, Ecolab, Inc., ABM Industries, and Carlisle Holdings Ltd. Advanced Business Valuations noted that the equity value-to-revenue multiples ranged from 1.04 to 2.23 times, and equity value to earnings multiples ranged from 22.90 to 29.91 times.

Valuation Overview. The following table provides a summary of the range of indicated values for per share of our common stock for each of the analyses used by Advanced Business Valuations.

<u>Methodology</u>	Indicated Equity Value Per Share
Comparable Transaction Analysis	\$4.94 - \$6.58
Discounted Cash Flow Analysis	\$3.53 - \$3.94
Adjusted Net Book Value Analysis	\$4.28 - \$4.55

Financial Performance Analysis. Advanced Business Valuations undertook analyses of our historical and financial data in order to understand and interpret its operating and financial performance and strength.

Advanced Business Valuations reviewed our historical financial data from our public filings for the three years ended September 30, 2003, 2002 and 2001, and the unaudited financial statements for the year ended September 30, 2004. The following discussion excludes our recent acquisition of Percipia, Inc. and its wholly-owned subsidiary Percipia Networks, Inc. (collectively, Percipia) in August 2004 for comparative purposes. Advanced Business Valuations noted the following:

Balance sheet: Our balance sheet, as of the dates reviewed is strong. Our current ratio was approximately 17.3x, as of September 30, 2004. Our total liabilities over total assets ratio was approximately 0.13x as of September 30, 2004. As of September 30, 2004, we had approximately \$10,233,000 of current assets against current liabilities of approximately \$591,000. Our cash and cash equivalents position at September 30, 2004 was approximately \$2,443,000, after excluding \$1,500,000 of cash reserved for the acquisition of the assets of Telecom FM (which closed in October 2004). Our cash balance suggests that we are currently capable of meeting our current obligations.

As of September 30, 2004, our current assets were approximately \$10,233,000, consisting primarily of cash of approximately \$2,443,000 (net of cash reserved for the acquisition of the assets of Telecom FM of \$1,500,000), accounts receivable of approximately \$1,094,000, inventory of \$6,433,000 and \$224,000 in interest receivable.

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Based on Advanced Business Valuations review of the accounts receivable and inventory Advanced Business Valuations believe these balance appear reasonable as stated.

As of September 30, 2004, our non-current assets consisted primarily of fixed assets of approximately \$564,000 (net of accumulated depreciation) and \$8,695,000 in other assets. These other assets were comprised of approximately \$2,960,000 in investments of marketable securities, approximately \$1,931,000 in investments in Percipia and Telecom FM, approximately \$1,970,000 in loans to Percipia and \$1,500,000 in cash reserved for the acquisition of the assets of Telecom FM.

As of September 30, 2004, our current liabilities were approximately \$591,000 and were primarily comprised of approximately \$525,000 in accounts payable and \$66,000 in taxes payable. As of September 30, 2004, we had \$2,000,000 in bank debt, which we had recently obtained for the acquisition of the assets of Telecom FM in October 2004. Our shareholders equity was approximately \$16,901,000 as of September 30, 2004.

Income Statement Items: For the year ended September 30, 2004, we had total revenues of approximately \$8,227,000, the cost of goods sold was approximately \$4,670,000, operating expenses (excluding depreciation expense) was approximately \$1,887,000 and depreciation expense was approximately \$150,000. Our net income for the year ended September 30, 2004, was approximately \$1,203,000 or 14.6% of total revenues. For the year ended September 30, 2003, we had total revenues of approximately \$5,911,000, the cost of goods sold was approximately \$3,293,000, operating expenses (excluding depreciation expense) was approximately \$1,620,000 and depreciation expense was approximately \$150,000. Our net income for the year ended September 30, 2003, was approximately \$776,000 or 13.1% of total revenues.

Market Performance Analysis. Advanced Business Valuations utilized a historical stock price analysis to review and compare our stock performance to the general market indices and a selected peer group. In addition, Advanced Business Valuations reviewed the liquidity of our common stock in the public trading markets.

Advanced Business Valuations reviewed the daily closing market price and trading volume of our common stock over two time periods: (i) the two-year period ending October 31, 2004, and (ii) the last twelve months ended October 31, 2004. Advanced Business Valuations compared the daily closing market price performance of our common stock to the Russell 3000 Index (RUA) for both periods. Advanced Business Valuations also calculated total trading volumes at various closing price ranges. In addition, the number of trading days, and the respective percentages, at certain trading volumes, was set forth.

Advanced Business Valuations noted that during the two-year period ended October 31, 2004, our common stock:

experienced limited liquidity with the average and median daily number of shares traded equal to 6,527 and 3,000, respectively. It was further noted that on 38 trading days, or approximately 8% of the total trading days, there was no volume and on 121 trading days, or approximately 24% of the total trading days, the volume was below 1,000 shares traded per day;

ranged from as high as \$7.80 to as low as \$2.60, the average and median closing prices were \$4.65 and \$4.63, respectively and the closing price on October 31, 2004 was \$4.89; and

increased 74.6%, while the Russell 3000 Index increased 28.5%.

Advanced Business Valuations also noted that during the last twelve months ended October 31, 2004, our common stock:

experienced limited liquidity with the average and median daily number of shares traded equal to 8,189 and 3,800, respectively. It was further noted that on 12 trading days, or approximately 5% of the total trading days, there was no volume and on 48 trading days, or approximately 19% of the total trading days, the volume was below 1,000 shares traded per day;

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ranged from as high as \$7.80 to as low as \$4.36, the average and median closing prices were \$5.67 and \$5.65, respectively and the closing price on October 31, 2004 was \$4.89; and

increased 7.5%, while the Russell 3000 Index increased 7.7%.

Selected Comparable Transaction Analysis. Advanced Business Valuations utilized the selected comparable transaction analysis, a market valuation approach, for the purposes of compiling precedent or comparable transaction statistics and developing valuation metrics based on the pricing in such transactions.

Information is typically not disclosed for transactions involving a private seller, even when the buyer is a public company, unless the acquisition is deemed to be material for the acquirer. As a result, the selected comparable transaction analysis is limited to transactions involving the acquisition of a public company, or substantially all of its assets, or the acquisition of a large private company, or substantially all of its assets, by a public company.

Advanced Business Valuations located two transactions announced since January 2001 involving target companies in related industries to ours and for which detailed financial information was available and 15 transactions announced since January 1997 involving target companies classified by Pratt's Stats as being in the SIC code 3663-Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing. The primary two transactions were Titan Corporation's acquisition of Datron Systems, Incorporated in September 2001 and Raytheon Company's acquisition of JPS Communications, Inc. in December 2002.

Based on the information disclosed with respect to the targets in each of the comparable transactions, Advanced Business Valuations determined a range of indicated enterprise values for us by selecting a range of valuation multiples based on the comparable transactions, and then applied them to our common equity, FY2004 revenue, FY2004 EBIT and FY2004 earnings.

Our unique characteristics, smaller size, historical performance and higher business risk characteristics would suggest we be valued below the average of the comparable transaction multiples.

Based on the selected multiple ranges, Advanced Business Valuations calculated a range of equity values. Advanced Business Valuations calculated a range of indicated equity values per share of between \$4.94 and \$6.58 after including \$3.5 million in additional equity value for certain investments in subsidiaries and based on 4,152,570 shares of common stock issued and outstanding on a fully diluted basis.

	Statistic \$ (000)	Selected Multiple		Indicated Equity Value Per Share	
		Low	High	Low	High
Equity Value Multiple					
Common Equity	\$ 16,900	1.34x	2.71x	\$ 6.38	\$ 11.95
FY2004 Revenue	\$ 8,227	0.50x	1.83x	\$ 1.91	\$ 4.54
FY2003 EBIT	\$ 1,741	11.78x	11.78x	\$ 5.86	\$ 5.86
FY2003 Earnings	\$ 1,203	16.54x	16.54x	\$ 5.71	\$ 5.71
Enterprise Value Multiple					
FY2004 Revenue	\$ 8,227	1.97x	1.97x	\$ 4.82	\$ 4.82
Indicated Reference Range-Average				\$ 4.94	\$ 6.58

None of the comparable transactions are identical to the transaction. Accordingly, an analysis of comparable business combinations is not mathematical; rather it involves complex considerations and judgments concerning

differences in financial and operating characteristics of the target companies in the comparable transactions and other factors that could affect the respective acquisition values.

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Discounted Cash Flow Analysis. Advanced Business Valuations utilized the discounted cash flow analysis (DCF), an income valuation approach, in order to develop valuation metrics based on the present value of expected perpetual returns.

In performing the analysis, Advanced Business Valuations obtained from our management team projections for the 3 year period ending September 30, 2007.

To estimate the future net cash flow attributable to the equity investors, the following components of cash flow were considered: net cash flow from operating activities, investing activities and financing activities. This analysis considered operating income before taxes, interest expense, taxes, non-cash items (e.g., depreciation and amortization expense), capital expenditures, incremental working capital and long-term debt.

A company s expected cash flow can be separated into two time periods and the company s value is defined as follows: the present value of the cash flow during the projected period plus the company s terminal value. The second term in this equation is the company s continuing value. Using simplifying assumptions about the company s performance during this period permits us to estimate continuing value instead of having to forecast in detail the company s cash flow over an extended period. The terminal value is of great importance because it often accounts for a large percentage of the total value of the company.

To calculate the terminal value Advanced Business Valuations use the principles of the Gordon Growth Model, which expressed in a formula are as follows:

$$\text{Terminal Value} = \text{FCF} / (\text{K} - \text{g})$$

Where:

FCF = the normalized level of free cash flow in the last year of the projections terminal growth rate multiplied by the expected

K = the discount rate or the WACC (defined below).

g = the expected terminal growth rate.

Once the net debt free cash flow was estimated these amounts were discounted back to present value using the company s estimated weighted cost of capital (WACC). The WACC is representative of the company s total cost of capital. The WACC provides the expected rate of return for the company based on the average proportions of debt (D) and equity (E) in the company s capital structure, current market yield on equity (re) and the current yield on the long-term debt (rd) by one minus the tax rate (1-T) of the company. The weighted debt and equity costs are combined in the WACC equation as follows:

$$\text{WACC} = E(\text{re}) + D(\text{rd})(1-\text{T})$$

After giving due consideration to various traditional models for determining the required equity rate of return, Advanced Business Valuations employed the Build-Up Model. The Build-Up Model equation used in practice is as follows:

$$\text{re} = \text{Rf}1 + (E[\text{Rm}] - \text{Rf}2) + \text{size premium} + a$$

Where:

re = equity rate of return or discount rate.
Rf1 = the risk free rate as of the valuation date (20 year Treasury Bonds).
E[Rm-Rf2] = the expected return on the market in excess of the historical risk free rate.
a = specific company risk premium and industry risk premium.

The WACC vary among particular sizes and types of businesses and from one period of time to another. In determining the WACC, Advanced Business Valuations has considered many of the factors effecting our present and future operations. Advanced Business Valuations has reflected on both the systematic and unsystematic risk

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factors. That is, Advanced Business Valuations has considered the risk involved in operating such a company in the present-day business, market, economic and demographic environments. Systematic risk is the portion of the risk that is related to movements in the general market rather than to the industry-specific or company-specific factors. Unsystematic risk is that portion of the risk that relates to the specific industry or company rather than the general marketplace.

In addition to the basic rate, a Specific Risk Premium and Industry Risk Premium was added ranging from 0% to 2%. A specific risk premium and industry risk premium allows for the special risk characteristics of the specific business not accommodated by the general risk premium. In this adjustment Advanced Business Valuations consider, among other things, adjustments for competition, financial strength, Management's ability and depth, profitability, stability of earnings and national and local economics and industry risks.

Based on Advanced Business Valuations' review of the industry and economic data and their discussions with our management team, Advanced Business Valuations believe a 4.0% growth rate is appropriate in estimating the terminal value.

Based on our financial position, our historical and projected growth, our risks factors, our level of debt, Advanced Business Valuations study and analytical review procedures and all other facts Advanced Business Valuations deem relevant, Advanced Business Valuations has determined a reasonable estimate of the WACC to be between 17% and 19%.

Advanced Business Valuations estimated the indicated market value of our invested capital by discounting back to present value the net debt free cash flow. This indicated value was then reduced by our interest bearing debt, which was assumed to be zero for purposes of this computation.

Advanced Business Valuations then determined a range of indicated equity values of \$14.6 million to \$16.3 million after including \$3.5 million in additional equity value for certain investments in subsidiaries and the cash assumed collected on the diluted options of approximately \$328,000. Advanced Business Valuations derived a range of indicated equity values per share of between \$3.53 and \$3.94 based on 4,152,570 shares of common stock issued and outstanding on a fully diluted basis.

Adjusted Net Book Value Analysis. An adjusted book value analysis utilizes a company's most recent balance sheet to estimate the current realizable market value of the company's assets. A company's financial statements, including the balance sheet, are prepared according to generally accepted accounting principles and generally reflect historical cost amounts and do not reflect current market value.

Based upon discussions with our management team, Advanced Business Valuations applied a range of expected realizations from our assets assuming they were properly marketed over a reasonable period of time. The following adjustments were made:

Prepaid and other assets reflect our inability to either recover or sell the assets.

Property, plant and equipment reflect proceeds from sales.

Our investment in Percipia and Telecom FM reflects our ability to either convert to cash or sell the investments.

Our ability to either convert to cash or sell the our high frequency single sideband communications business.

Increase in other current liabilities represents the taxes payable on the sale of our high frequency single sideband communications business and the sale of the building and other fixed assets.

Assume the exercising of 145,950 stock options at \$2.25 per option.

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Advanced Business Valuations determined the adjustments to net book value to range between approximately \$3.2 million and \$4.4 million. As such, the range of indicated values was approximately \$20.1 million to \$21.3 million. Advanced Business Valuations then assumed realization costs of 2.5% of total assets to reflect legal, accounting, and other disposal costs. Additionally, based upon discussions with Management, Advanced Business Valuations determined that it would take on average one year to complete the realization of value from our assets. Assuming a discount rate of 10%, Advanced Business Valuations calculated a range of indicated equity values per share of between \$4.28 and \$4.55 based on 4,152,570 shares of common stock issued and outstanding on a fully diluted basis.

The adjustments may not anticipate all the economic, socioeconomic, political, market or legal factors that impact realizable values. The net book value analysis involves complex considerations and judgments concerning realization and timing that could affect indicated values.

Advanced Business Valuations performed a variety of financial and comparative analyses for the purpose of rendering the Advanced Business Valuations opinion. While the foregoing summary describes all material analyses and factors reviewed by Advanced Business Valuations with our Board of Directors, it does not purport to be a complete description of the presentations by Advanced Business Valuations or the analyses performed by Advanced Business Valuations in arriving at its opinion. The preparation of a fairness opinion is a complex process and is not necessarily susceptible to partial analysis or summary description. In addition, Advanced Business Valuations may have given various analyses more or less weight than other analyses, and may have deemed various assumptions more or less probable than other assumptions, so that the range of valuations resulting from any particular analysis described above should not be taken to be Advanced Business Valuations' view of our actual value. In performing its analyses, Advanced Business Valuations made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond our control. The analyses performed by Advanced Business Valuations are not necessarily indicative of actual values or actual future results, which may be significantly more or less favorable than suggested by such analyses. In addition, analyses relating to the value of businesses or assets do not purport to be appraisals or to necessarily reflect the prices at which businesses or assets may actually be sold. The analyses performed were prepared solely as part of Advanced Business Valuations' analysis of the fairness of the purchase price, from a financial point of view, to our shareholders, and were provided to our Board of Directors in connection with the delivery of Advanced Business Valuations' opinion.

As part of its financial advisory services, Advanced Business Valuations receives a fee in connection with the preparation and issuance of its opinion in the amount of \$50,000 plus all out of pocket expenses. The total consulting fees plus out of pocket expenses as of the date of this proxy statement is \$50,812. The fee paid in connection with the preparation and issuance of its opinion was recommended by Advanced Business Valuations and accepted by us. In addition, we have agreed to indemnify Advanced Business Valuations for certain liabilities that may arise out of the rendering of the opinion. Advanced Business Valuations is a valuation/financial advisory firm that, as part of its business, regularly is engaged in the valuation of businesses and their securities in connection with mergers, acquisitions, corporate restructurings, private placements, and for other purposes. Advanced Business Valuations does not beneficially own any interest in us, nor has Advanced Business Valuations maintained any material relationships with us, aside from normal valuation business services provided to nor, nor is any material relationship between us and Advanced Business Valuations mutually understood to be contemplated other than as described in this proxy statement.

Based on the foregoing, including the opinion of Advanced Business Valuations, our Board of Directors has unanimously approved and adopted the transaction, and determined that it is in best interests of our company and the best interests of our shareholders to issue to Coconut Palm up to 5,000,000 shares of our common stock and up to an additional 10,000,000 shares of our common stock upon the exercise of warrants issued to Coconut Palm, and unanimously recommends that you vote FOR this Proposal 1.

The affirmative vote of the majority of the votes cast by the holders of our common stock present or represented by proxy and voting on the matter is required to approve this Proposal 1.

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PROPOSAL NO. 2

Increase in the Size of our Board of Directors from 5 to 7 Members

In connection with the transaction, we have agreed to increase the size of our Board of Directors from 5 to 7 members, and to allow Coconut Palm Capital Investors II, Ltd. (Coconut Palm) to nominate 1 additional director to fill the newly created vacancy, which such nominee will be elected by a majority vote of our Board of Directors within 30 days of the Annual Meeting of Shareholders (the Annual Meeting), as provided by our bylaws.

Our Articles of Incorporation provide that our Board of Directors must consist of no less than 3 and no more than 11 members, and that such number may be set from time to time in accordance with our bylaws. Our bylaws provide that the number of directors on our Board of Directors must be determined by our shareholders. Our Board of Directors presently consists of 5 members. Therefore, we are seeking shareholder approval to fix the size of our Board of Directors at 7 members.

In addition, if Steven P. Oppenheim, who is one of the director nominees, is elected by our shareholders at the Annual Meeting, he will resign from our Board of Directors upon the closing of the Transaction, and Coconut Palm will have the right to nominate an additional director to fill the vacancy created by Mr. Oppenheim's resignation, which such nominee will be elected by a majority vote of our Board of Directors within 30 days after the vacancy is created, as provided by our bylaws.

The affirmative vote of a majority of the votes cast by holders of our common stock present or represented by proxy and voting on the matter is required to approve this Proposal 2.

Our Board of Directors has determined that it is in best interests of our company and the best interests of our shareholders to fix the size of our Board of Directors at 7 members, and unanimously recommends that you vote FOR this Proposal 2.

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PROPOSAL NO. 3

Amendment to our Articles of Incorporation

As a result of the shift in focus of our business, as contemplated in the purchase agreement between us and Coconut Palm Capital Investors II, Ltd., we have agreed to amend our Articles of Incorporation to: (i) change our corporate name from Sunair Electronics, Inc. to Sunair, Inc.; (ii) change the description of the general nature of our business from the electronics industry to any business permitted by law; and (iii) increase the number of our authorized shares of capital stock to 108,000,000 shares, of which 100,000,000 shares will be common stock and 8,000,000 shares will be preferred stock.

We have agreed to amend Article I of our Articles of Incorporation in its entirety to read as follows:

ARTICLE I

NAME

The name of the corporation shall be SUNAIR, INC.

We have also agreed to amend Article II of our Articles of Incorporation in its entirety to read as follows:

ARTICLE II

GENERAL NATURE OF BUSINESS

The purpose or purposes of the corporation shall be to engage in any lawful act or activity for which corporations may be organized under the Florida Business Corporation Act, as amended from time to time.

We have further agreed to amend Article III of our Articles of Incorporation in its entirety to read as follows:

ARTICLE III

AUTHORIZED STOCK

1. Authorized Stock. The total number of shares which this corporation is authorized to issue is one hundred and eight million (108,000,000) shares, of which one hundred million (100,000,000) shares shall be common stock, par value \$0.10 per share (Common Stock), and eight million (8,000,000) shares shall be preferred stock, no par value per share (the Preferred Stock).

2. Common Stock. Subject to the requirements of law, these Articles of Incorporation, as amended from time to time, and the resolution or resolutions of the Board of Directors creating or amending any series of the Preferred Stock, the holders of Common Stock shall (i) in the event of any liquidation, dissolution or other winding up of the corporation, whether voluntary or involuntary, and after all holders of the Preferred Stock shall have been paid in full the amounts to which they respectively shall be entitled, be entitled to receive all the remaining assets of the corporation of whatever kind, such assets to be distributed pro rata to the holders of the Common Stock; and (ii) after payment in full of all dividends to which holders of the Preferred Stock shall be entitled, be entitled to receive such dividends as and when the same may be declared from time to time by the Board of Directors out of funds legally available therefor. Except as otherwise required by law and the provisions of these Articles of Incorporation, as amended from time to time, and except as provided by the resolution or resolutions of the Board of Directors creating or amending any series

of Preferred Stock, the holders of Common Stock possess full voting power for the

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election of directors and for all other purposes, and each holder thereof shall be entitled to one vote for each share held of record by such holder on all matters on which shareholders generally are entitled to vote.

3. **Preferred Stock.** The Preferred Stock shall be issued in one or more series. The Board of Directors of the corporation is hereby expressly authorized to issue the shares of Preferred Stock in such series and to fix from time to time before issuance the number of shares to be included in any series and the designation, relative rights, preferences and limitations of all shares of such series. The authority of the Board of Directors with respect to each series shall include, without limitation thereto, the determination of any or all of the following, and the shares of each series may vary from the shares of any other series in the following respects:

- (a) the number of shares constituting such series and the designation thereof to distinguish the shares of such series from the shares of all other series;
- (b) the annual dividend rate on the shares of that series and whether such dividends shall be cumulative and, if cumulative, the date from which dividends shall accumulate;
- (c) the redemption price or prices for the particular series, if redeemable, and the terms and conditions of such redemption;
- (d) the preference, if any, of shares of such series in the event of any voluntary or involuntary liquidation, dissolution or winding-up of the corporation;
- (e) the voting rights, if any, in addition to the voting rights prescribed by law and the terms of exercise of such voting rights;
- (f) the right, if any, of shares of such series to be converted into shares of any other series or class and the terms and conditions of such conversion; and
- (g) any other relative rights, preferences and limitations of that series.

A copy of the entire text of the Articles of Amendment to our Articles of Incorporation, which sets forth the amendments discussed above is attached as Annex C to this proxy statement. The above description of the amendments to our Articles of Incorporation is a summary only and you should read the proposed amendments that are attached to this proxy statement in their entirety.

Our Board of Directors is empowered to authorize the issuance of shares of our common stock. Of the 25,000,000 shares of our common stock presently authorized for issuance, [4,014,870] shares of our common stock were issued and outstanding as of the record date and [145,950] shares are reserved for issuance upon exercise of options granted under our existing equity compensation plan. If the transaction is approved, we may issue to Coconut Palm up to a total of 5,000,000 shares of our common stock, and will reserve up to 10,000,000 shares of our common stock for issuance upon exercise of the warrants that will be issued to Coconut Palm. In addition, we have agreed to reserve: (i) 500,000 shares of our common stock for issuance upon the conversion of options that will be issued to Messrs. Hayes, Karnes and Slott, in connection with entering into their respective employment agreements with us upon the closing of the transaction; (ii) an aggregate of 60,000 shares of our common stock for issuance upon the conversion of options that will be issued to 3 of our current directors outside of our existing stock option plan, if our shareholders approve Proposal 5; and (iii) 800,000 shares of our common stock for issuance upon the conversion of options that may be issued under the 2004 Plan, if our shareholders approve Proposal 6. Accordingly, if the transaction and Proposals 5 and 6 are approved, assuming the issuance of all shares of common stock that will be reserved for future issuance, we will have issued [20,520,820] of the 25,000,000 shares of our common stock

currently authorized for issuance, leaving only [4,479,180] shares authorized for subsequent issuance. If this Proposal 3 is approved, approximately [79,479,180] shares of our common stock will be available for future issuance, in addition to the shares currently issued or reserved for issuance. The additional 75,000,000 shares of our common stock would be part of the existing class of our common stock and, if and when issued, would have the same rights and privileges as the shares of our common stock presently issued and outstanding. Future issuances of our common stock could result in dilution to our existing shareholders.

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Of the 2,000,000 shares of our preferred stock presently authorized for issuance, no shares were issued and outstanding as of the record date, and no shares were reserved for issuance. If this Proposal 3 is approved, 8,000,000 shares of preferred stock will be available for future issuance. Our Board of Directors will be expressly authorized to issue the shares of preferred stock in one or more series and to fix from time to time before issuance the number of shares to be included in any series and the designation, relative rights, preferences and limitations of all shares of such series.

Our Board of Directors believes that it is in our best interest to increase the authorized number of shares of our capital stock to 108,000,000 shares, of which 100,000,000 shares will be common stock and 8,000,000 shares will be preferred stock, so that there will be a substantial number of authorized but unissued shares of our capital stock available for issuance, from time to time, in the discretion of our Board of Directors, and in such amounts, for such purposes and on such terms as our Board of Directors may from time to time determine, without further shareholder approval except as may be required by applicable laws, rules and regulations. Our Board of Directors believes that an increase in the authorized shares of our capital stock will give us added flexibility to act in the future with respect to equity offerings, acquisitions, financing programs, stock dividends or splits, corporate planning and other corporate transactions without delay and expense of shareholder action each time an opportunity requiring the issuance of shares may arise. In addition, our proposed strategy for entering into the pest and termite control services industry, as described in this proxy statement, may require us to enter into acquisitions, the consideration for which may be shares of our capital stock.

In addition to these corporate purposes, an increase in the number of authorized shares of our capital stock could be used to make more difficult a change in control of our company. Under some circumstances our Board of Directors could create impediments to, or frustrate persons seeking to effect, a takeover or transfer of control of us by causing such shares of our capital stock to be issued to a holder or holders who might side with our Board of Directors in opposing a takeover bid that our Board of Directors determines is not in our best interests and the best interests of our shareholders. Furthermore, the existence of these additional authorized shares of our capital stock might have the effect of discouraging any attempt by a person or entity, through the acquisition of a substantial number of shares of our capital stock, to acquire control of our company, because the issuance of these additional shares of our capital stock could dilute the stock ownership of such person or entity. We are not aware of any of these actions that may be proposed or pending.

Under Section 607.1002 of the Florida Business Corporation Act, our Board of Directors may adopt one or more enumerated amendments to our Articles of Incorporation without shareholder action (i.e., extending the duration of our corporation, deleting information that is solely of historical interest, changing our corporate name by substituting Inc. for a similar word or abbreviation in the name, etc). Because the proposed amendments to our Articles of Incorporation are out of the purview of Section 607.1002, such amendments must instead be adopted by a two-step process involving, first the recommendation by our Board of Directors and, second, approval by our shareholders, pursuant to Section 607.1003 of the Florida Business Corporation Act. If the amendments to our Articles of Incorporation are approved at the Annual Meeting of Shareholders, they will become effective upon the filing of Articles of Amendment to our Articles of Incorporation with the Secretary of State of the State of Florida, which is expected to be accomplished as promptly as practicable after such approval is obtained.

The affirmative vote of the holders of a majority of the shares of our common stock entitled to vote on the matter is required to approve this Proposal 3.

Our Board of Directors has determined that it is in best interests of our company and the best interests of our shareholders to amend our Articles of Incorporation, and unanimously recommends that you vote FOR this Proposal 3.

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PROPOSAL NO. 4

Election of Directors

We are also seeking shareholder election of 6 members to our Board of Directors, provided our shareholders approve Proposal 2 in this proxy statement, with the 1 additional newly created vacancy to be filled by a Coconut Palm Capital Investors II, Ltd. (Coconut Palm) nominee within 30 days of the Annual Meeting of Shareholders (Annual Meeting), as provided by our bylaws. In addition, if Steven P. Oppenheim, who is one of the director nominees, is elected by our shareholders at the Annual Meeting, he will resign from our Board of Directors upon the closing of the Transaction, and Coconut Palm will have the right to nominate an additional director to fill the vacancy created by Mr. Oppenheim's resignation, which such nominee will be elected by a majority vote of our Board of Directors within 30 days after the vacancy is created, as provided by our bylaws.

If elected, each of the nominees, other than Mr. Oppenheim, shall serve until the 2005 Annual Meeting of Shareholders, expected to be held in January 2006, or until their successors have been duly elected and qualified.

Messrs. Richard C. Rochon and Mario B. Ferrari, each of whom is a nominee and affiliate of Coconut Palm, as well as Michael D. Herman, Arnold Heggstad, Ph.D., James E. Laurent and Steven P. Oppenheim, have been nominated to serve as our directors. We have no reason to believe that any of these nominees will not be a candidate or will be unable to serve as director. However, in the event that any nominee should become unable or unwilling to serve as a director, the proxy will be voted for the election of the person or persons as shall be nominated by our Board of Directors with the consent of Coconut Palm.

Messrs. Herman, Heggstad, Laurent and Oppenheim are current members of our Board of Directors.

Gerard P. Laheney, a current member of our Board of Directors, has informed us that he does not intend to run for re-election to our Board of Directors.

The election of Messrs. Rochon and Ferrari to our Board of Directors, as Chairman and Vice Chairman, respectively, the resignation of Mr. Oppenheim from our Board of Directors and the filling of any vacancies by Coconut Palm nominees, are contingent upon the closing of the transaction. If the transaction does not close, the election of Messrs. Rochon and Ferrari to our Board of Directors will not go into effect, Mr. Oppenheim will not resign from our Board of Directors, and no vacancies will be filled by Coconut Palm nominees.

Nominees

Michael D. Herman, 47, became the Chairman of our Board of Directors on November 6, 2003 pursuant to a stock purchase agreement entered into on August 14, 2003 and completed November 6, 2003. From 1992 until 1999 Mr. Herman was, and since December, 2003 Mr. Herman has been, Chairman and majority stockholder of Telematrix, Inc., a Colorado Springs, CO based designer and marketer of a wide range of telephones and peripheral equipment for the commercial, residential and hospitality markets worldwide. From 1999 until November 2003 he was a private investor.

Arnold Heggstad, Ph.D., 61, was appointed to our Board of Directors on March 11, 2003. Dr. Heggstad is the Holloway Professor of Finance and Entrepreneurship at the University of Florida and has been at the University since 1974. Dr. Heggstad has served as Chairman, Department of Finance, Insurance and Real Estate, Associate Dean, College of Business Administration, Director of the Center for Financial Institutions, Executive Director, University of Florida Research Foundation, Associate Vice-President of Entrepreneurial Programs in the Office of Research. Dr.

Heggestad is a director of Intrepid Capital Management, Inc. He has been very active in public service and has served both public and private interests in a number of capacities.

James E. Laurent, 68, has served on our Board of Directors since December 1, 2000 and became President of our company on October 1, 2000 and Chief Executive Officer on December 1, 2000. Mr. Laurent previously served as Vice-President of Marketing for our company beginning in 1988. After retirement from the United States

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Air Force in 1978, he held management positions for sales and marketing in the communications-electronics field for international and U.S. government and military market segments.

Steven P. Oppenheim, 58, was appointed to our Board of Directors in January 2004. Mr. Oppenheim is the President and owner of Oppenheim & Associates, Miami, FL, which, since 2002 has provided a wide range of consulting and strategic planning services to a diversified international clientele in the U.S., Europe and Latin America. Mr. Oppenheim holds a Juris Doctor Degree and maintained his own law firm from 1975 until 2001. From 1973 to 1975 he was tax supervisor for Coopers & Lybrand, CPA s. Mr. Oppenheim serves in various officer capacities for several multinational companies or affiliates involving U.S business. He serves as a Director of the International Advertising Association and as a Director and Vice President of the British American Chamber of Commerce. He previously served as a Director of the French-American Chamber of Commerce, Italy-America Chamber of Commerce, and European-American Chamber of Commerce.

Richard C. Rochon, 47, is currently Chairman and Chief Executive Officer of Royal Palm Capital Partners LLLP, a private investment and management firm. Previously, Mr. Rochon served for 14 years as President of Huizenga Holdings, Inc. a management and holding company owned by H. Wayne Huizenga. Mr. Rochon was a 17 year veteran of the Huizenga organization, joining in 1985 as Treasurer and promoted to President in 1988. Huizenga Holdings' investments included several publicly-held companies that became market leaders in their respective industries, including Blockbuster Entertainment Corporation, Republic Waste Industries, Inc., AutoNation, Inc., and Boca Resorts, Inc. Mr. Rochon has also served as sole director for many of Huizenga Holdings' portfolio companies and has served as Vice Chairman of Huizenga Holdings. Mr. Rochon continues to serve as a director of publicly-held Devcon International Corp., Century Business Services, Inc. and Bancshares of Florida, Inc. From 1979 until 1985 Mr. Rochon was employed as a certified public accountant by the public accounting firm of Coopers & Lybrand. L.L.P. Mr. Rochon received his B.S. in Accounting from Binghamton University (formerly State University of New York at Binghamton) in 1979 and his Certified Public Accounting designation in 1981.

Mario B. Ferrari, 27, is currently a principal with Royal Palm Capital Partners, LLLP, a private investment and management firm, joining in 2002. He continues to serve as a director of publicly-held Devcon International Corp. Previously, he worked as an investment banker with Morgan Stanley & Co. from 2000 to 2002, where he served as a founding member of the Private Equity Placement Group. Previously from 1997 thru 1999, Mr. Ferrari was co-founder of PowerUSA, LLC, a retail energy services company. Mr. Ferrari received his B.S. in Finance and International Business, magna cum laude, from Georgetown University.

If elected, these nominees will assume office upon the completion of the transaction. All nominees, other than Mr. Oppenheim, will hold office until the 2005 Annual Meeting of Shareholders, expected to occur in January 2006, or until their successors have been duly elected and qualified.

Information Regarding our Board of Directors and Committees of our Board of Directors

Attendance at Board of Directors and Committees Meetings

During the 2004 fiscal year, our Board of Directors held 8 meetings and the Audit Committee held 9 meetings. Attendance was 100% at of our Board of Directors meetings and 100% at the Audit Committee meetings.

Directors' Fees

Directors who are not full-time employees of our company were paid an annual retainer in 2004 of \$20,000, payable quarterly, an attendance fee of \$1,000 for each meeting of our Board of Directors, plus travel expenses

incurred in connection therewith, and a fee of \$1,000 for participation in Board of Directors and committee meetings held telephonically. The Audit Committee consists of two non-management Board of Directors members, who are paid \$1,000 each for each committee meeting. Directors who are full-time employees of our company are not paid any fees or additional remuneration for services as members of our Board of Directors or any committee thereof.

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Committees and Meetings of our Board

Our Audit Committee is the sole functioning committee of our Board of Directors. For more information about our Audit Committee and its Audit Committee Report, see *Audit Committee* beginning on page 58.

We do not have a standing nominating committee or committee performing similar functions because we believe that as a small business issuer, it is not necessary to have a separate nominating committee. Rather, the full Board of Directors participates in the consideration of director nominees. In addition, because Mr. Herman owns a majority of our common stock, we are not required under the rules of the American Stock Exchange to have a separate nominating committee. At this time our Board of Directors does not have a policy with regard to the consideration of any director candidates recommended by shareholders because historically we have not received recommendations from our shareholders and the costs of establishing and maintaining procedures for the consideration of shareholder nominations would be overly burdensome.

In making its nominations, our Board of Directors identifies candidates who meet the current challenges and needs of our Board of Directors. In determining whether it is appropriate to add or remove individuals, our Board of Directors will consider issues of judgment, diversity, age, skills, background and experience. In making such decisions, our Board of Directors considers, among other things, an individual's business experience, industry experience, financial background and experiences. Our Board of Directors uses multiple sources for identifying and evaluating nominees for directors including referrals from current directors and input from third party executive search firms.

Nominations of Specified Directors to our Board of Directors and Additions to our Management Team

As a result of Coconut Palm's desire that it be provided with sufficient ability to monitor and protect its investment, our Board of Directors has approved the nominations of Messrs. Rochon and Ferrari to our Board of Directors, as Chairman and Vice Chairman, respectively.

As to Messrs. Rochon and Ferrari, see *Nominees* on page 31. See also *Relationship of Richard C. Rochon and Mario B. Ferrari to Coconut Palm Capital Investors II, Ltd.* on page 48.

In addition, John J. Hayes will become our President and Chief Executive Officer, and Donald K. Karnes and David M. Slott will become executive officers of our newly created Pest and Termite Control Services Division after the closing of the transaction. Messrs. Hayes, Karnes and Slott previously served as senior executives with TruGreen, a division of The ServiceMaster Company, a national service company that provides residential and commercial customers pest and termite control services.

Each of Messrs. Hayes, Karnes and Slott will enter into an employment agreement with us, which, by its terms, will be effective upon, and only upon, the closing of the transaction. We anticipate the aggregate compensation for this management team will be approximately \$975,000 in annual salary plus options to purchase 500,000 shares of our common stock at an exercise price of \$5.00 per share, which such options will be granted outside our stock option plan. Messrs. Hayes, Karnes and Slott will also be entitled to participate in our equity-based compensation plans and shall be entitled to other employee benefits to the same extent as our other similarly situated senior executives participate after the closing of the transaction.

Each of the employment agreements has a term of 3 years; however, such term may be further extended by us and the respective employee in writing in a separate signed instrument. Either we or the respective employee may terminate his employment agreement upon 60 days prior notice. However, if we terminate any employment agreement

without cause, or any employee terminates his employment agreement with cause, we are required to pay such employee severance payments at the rate of his salary in effect on the date of termination for 2 years. In the event of specified changes in control of our company, all options previously granted to the employees will automatically vest and if any employee terminates his employment with us with cause within one year of a specified change in control, he will be entitled to the 2 years of severance payments. However, no transaction will be considered to be a change in control for purposes of triggering these severance obligations if the transaction in question involves a pest and termite control services company or relates to any existing or former business segment or division in which we operate, or if the change in control is procured, directly or indirectly, by the employee,

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Richard C. Rochon, Mario B. Ferrari, Coconut Palm, any then existing executive officer or director of ours or any former executive director or officer previously affiliated with us during the 6 month period prior to the specified change in control and/or any affiliates of the foregoing. Each employee will be further subject to a 2 year noncompete covenant to the extent his employment is terminated in a manner that does not entitle him to the severance payments described above. Each employee will also be subject to a 2 year noncompete covenant to the extent his employment is terminated in a manner that does entitle him to the severance payments described above; however, if we fail to make these severance payments, such employee's noncompete obligations will no longer be in effect.

On December 10, 2004, The ServiceMaster Company (ServiceMaster) filed a suit against Messrs. Hayes, Karnes and Slott. We are not a party to this action. ServiceMaster alleged in its complaint that Messrs. Karnes and Slott had breached certain non-compete agreements with TruGreen and that Hayes had induced Karnes and Slott to breach these agreements. The complaint alleges that all three individuals had breached fiduciary duties owed to ServiceMaster, that the three individuals had usurped certain corporate opportunities and misappropriated trade secrets and that the three individuals would interfere with ServiceMaster's business relations with its customers and employees. The suit seeks to enjoin the named parties from performing services of any kind for any entity, including our company, planning to provide pest and termite control services. A hearing on this matter was first held on December 10, 2004. At this hearing, the Court restrained the named individuals from soliciting for employment any person who is, or with three months of the proposed hiring date was, an employee of TruGreen or its affiliates, including but not limited to Terminix, and from using or disclosing ServiceMaster's confidential information or trade secrets. The Court refused, however, to restrain the named individuals from (i) pursuing acquisitions of pest and termite control businesses identified as potential acquisition candidates, or (ii) performing, encouraging or inducing others to perform services for any entity, including our company, or from performing services competitive with those provided to TruGreen or its affiliates, including Terminix. A full evidentiary hearing on ServiceMaster's motion to enjoin the named individuals will be held on January 24, 2005. The purchase agreement contains a closing condition that the referenced individuals have not been enjoined from performing the contemplated services for the Pest and Termite Control Services Division. Although we and Coconut Palm have indicated our intent to consummate the transaction regardless of the outcome of the January 24, 2005 evidentiary hearing, either we or Coconut Palm may attempt to terminate the transaction if the hearing results in an injunction against Messrs. Karnes, Slott and Hayes.

John J. Hayes, 52, has served as executive vice president of TruGreen Companies (2000-2004), and has held various other executive roles with TruGreen Companies since 1975. Mr. Hayes will be employed as our President and Chief Executive Officer.

Donald K. Karnes, 54, has served as president of TruGreen Group (2001-2004), President of Terminix and TruGreen Group (1996-2000), and president and chief operating officer of TruGreen ChemLawn (1991-1996), and has held various other executive roles since 1979. Mr. Karnes will be employed as Chief Operating Officer of the newly formed Pest and Termite Control Services Division.

David M. Slott, 46, has served as president and chief operating officer of TruGreen ChemLawn (2002-2004), chief operating officer of TruGreen Companies (2001-2002), president and chief operating officer of TruGreen ChemLawn (1996-2000), and has held other executive roles since 1981. Mr. Slott will be employed as President of the newly formed Pest and Termite Control Services Division.

Although we are not involved with the distribution of the units or the securities comprising the units to the partners of Coconut Palm, Coconut Palm has advised us that it anticipates distributing certain warrants issued in the transaction to Messrs. Rochon and Ferrari. Coconut Palm has informed us that the warrants to be issued to these persons are for purposes of providing management and other services to Coconut Palm and to induce these individuals to become involved in the strategic oversight of our company.

The affirmative vote of a plurality of the votes cast by our shareholders is required to approve the election of each of the nominees set forth in this Proposal 4. You may vote in favor of, or you may withhold your vote from, the nominees. Votes that are withheld with respect to this matter will be excluded entirely from the vote and will have no effect, other than for purposes of determining the presence of a quorum.

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Our Board of Directors unanimously recommends that you vote FOR the election of each of the nominees set forth in this Proposal 4.

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PROPOSAL NO. 5

Issuance of Options to 3 of our Current Directors

On August 5, 2004, our Board of Directors approved the issuance of an aggregate of 60,000 options to purchase shares of our common stock to 3 of our current directors, Arnold Heggstad, Ph.D., Gerard P. Laheney and Steven P. Oppenheim, due to the contributions these individuals have made to our company. The options are exercisable at a price of \$4.79 per share and expire on August 5, 2009. The options are non-qualified stock options that were granted outside our stock option plan.

The rules of the American Stock Exchange require us to obtain shareholder approval for the issuance of any equity compensation arrangement pursuant to which our common stock, or options to acquire shares of our common stock, may be acquired by our officers, directors, employees, or consultants, regardless of whether or not such authorization is required by law or by our Articles of Incorporation, except in limited circumstances, including any issuances: (i) to an individual, not previously an employee or director, as a material inducement to entering into employment with our company; (ii) pursuant to tax-qualified, non-discriminatory employee benefit plans; (iii) a plan or arrangement relating to an acquisition or merger; or (iv) generally issued to all of our security holders (such as a typical dividend reinvestment plan).

Because the issuance of the option grants does not fit within one of the exceptions to the rules of the American Stock Exchange described above, we are seeking shareholder approval to ratify the issuance of the aggregate of 60,000 options to purchase shares of our common stock to Messrs. Heggstad, Laheney and Oppenheim.

The affirmative vote of the majority of the votes cast by the holders of our common stock present or represented by proxy and voting on the matter is required to approve this Proposal 5.

Our Board of Directors believes that it is in best interests of our company and the best interests of our shareholders to issue stock options to Messrs. Heggstad, Laheney and Oppenheim outside our stock option plan, and unanimously recommends that you vote FOR this Proposal 5.

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PROPOSAL NO. 6

Approval of Our 2004 Stock Incentive Plan

On December 15, 2004, our Board of Directors approved the 2004 Stock Incentive Plan (the 2004 Plan), subject to our shareholders' approval. We are seeking shareholder approval of the 2004 Plan under this Proposal 6. Our Board of Directors unanimously recommends that the shareholders approve the 2004 Plan.

The 2004 Plan

Our Board of Directors believes that our future success will be enhanced by our ability to maintain a competitive position in attracting, retaining and motivating individuals through the use of restricted stock, stock options and other equity-based awards. Our existing equity compensation plan has only limited shares available. The utility of our existing equity compensation plan is also restricted by limitations on the types of grants authorized and the eligible recipients of certain awards thereunder. As a result, our Board of Directors approved the 2004 Plan to replace our existing equity compensation plan, subject to the approval of our shareholders. Awards to be granted under the 2004 Plan are expected to consist primarily of restricted stock and stock options. The 2004 Plan will permit the granting of other forms of equity (i.e., restricted stock, restricted stock units, performance shares and performance units), as well as stock options, provide us with a reasonable number of shares to utilize (subject to strict limitations on the amount of grants during a fiscal year) and replace our existing equity compensation plan. Upon approval of the 2004 Plan, no additional grants will be made under our existing equity compensation plan.

The description of the 2004 Plan below is a summary of its principal provisions and is qualified in its entirety by reference to the 2004 Plan, a copy of which is attached hereto as Annex D.

Purpose

The purpose of the 2004 Plan is to enable us to offer employees and non-employee directors stock options, restricted stock, other equity awards and other performance-based stock incentives. The Company believes this will help it attract, retain and reward its employees and non-employee directors. If the 2004 Plan is approved, equity-based awards will no longer be permitted to be granted under the existing equity compensation plan.

Administration

The 2004 Plan will be administered by a committee of our Board of Directors (the Committee), consisting of two or more non-employee directors, each of whom is intended to be, to the extent required by Rule 16b-3 of the Exchange Act and Section 162(m) of the Code, a non-employee director under Rule 16b-3 and an outside director under Section 162(m) of the Code. With respect to the application of the 2004 Plan to non-employee directors, the Committee is our Board of Directors. If no Committee exists, the functions of the Committee will be exercised by our Board of Directors.

The Committee has the full authority to administer and interpret the 2004 Plan, to grant discretionary awards under the 2004 Plan, to determine the persons to whom awards will be granted, to determine the number of shares of our common stock to be covered by each award (subject to the individual participant limitations provided in the 2004 Plan), to prescribe the form of instruments evidencing awards and to make all other determinations and to take all such steps in connection with the 2004 Plan and the awards thereunder as the Committee, in its sole discretion, deems necessary or desirable.

The terms and conditions of individual awards will be set forth in written agreements consistent with the 2004 Plan. Awards under the 2004 Plan may not be made on or after the tenth anniversary of the date the 2004 Plan is approved by our shareholders, but awards granted prior to such date may extend beyond that date.

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Eligibility and Types of Awards

Under the 2004 Plan, non-employee directors and employees of our company and our subsidiaries are eligible to be granted stock options (incentive and non-qualified), restricted stock, restricted stock units, performance shares, performance units, stock awards and other stock-based awards. Eligibility for awards under the 2004 Plan is determined by the Committee, in its sole discretion. As of the date of this proxy statement, no awards have been granted under the 2004 Plan.

Available Shares

A maximum of 800,000 shares of our common stock may be issued pursuant to awards granted under the 2004 Plan. The maximum number of shares of our common stock subject to an option that may be granted under the 2004 Plan during any fiscal year to any individual is 80,000 shares. The maximum number of shares of our common stock subject to performance shares, restricted stock units and awards of common stock that may be granted under the 2004 Plan during any fiscal year to any individual is 80,000. In the case of performance units, a maximum value of the performance units granted during any fiscal year to any individual is \$1,000,000.

The Committee may, in accordance with the terms of the 2004 Plan, make appropriate adjustments to the number of shares of our common stock available for the grant of awards and the terms of outstanding options and other awards to reflect any stock dividend or distribution, stock split, reverse stock split, recapitalization, reorganization, merger, consolidation, split-up, combination or exchange of shares (and certain other events affecting our capital structure or business).

Awards Under the 2004 Plan

Stock Options. The 2004 Plan authorizes the Committee to grant stock options to purchase shares of our common stock to employees and non-employee directors of our company or any of our subsidiaries. Option grants may be in the form of incentive stock options (ISOs) or non-qualified stock options, provided that options granted to non-employee directors and employees of its subsidiaries that do not qualify as a subsidiary corporation (within the meaning of Section 424 of the Code) may only be non-qualified stock options. The Committee will determine the number of shares of our common stock subject to each option, the term of each option (which may not exceed ten years, or five years in the case of an ISO granted to a 10% shareholder), the exercise price, any vesting schedule, and the other material terms of each option. No ISO may have an exercise price less than the fair market value of our common stock at the time of grant (or, in the case of an ISO granted to a 10% shareholder, 110% of fair market value). Unless the Committee determines otherwise at the time of grant, options will vest and become exercisable in equal annual installments over four years following the grant date, subject to acceleration provisions (if any) as determined by the Committee. Options will remain exercisable for such times and be subject to such terms as determined by the Committee at grant. Upon the exercise of an option, the option holder must make payment of the full exercise price, either: (i) in cash, certified or cashier's check, bank draft or money order; (ii) to the extent permitted by law and the Committee, through a cashless exercise sale and remittance procedure by the delivery of irrevocable instructions to a broker reasonably acceptable to us to deliver promptly to us an amount equal to the aggregate purchase price; (iii) in shares of our common stock (which have been owned by the participant for a period of time as may be required by applicable accounting standards to avoid a charge to our earnings); (iv) to the extent permitted by law and the Committee, by delivery of a promissory note to us on such terms as the Committee shall specify or (v) on such other terms and conditions as may be acceptable to the Committee.

Restricted Stock. The 2004 Plan authorizes the Committee to award restricted stock to employees and non-employee directors. Recipients of restricted stock enter into an agreement with us subjecting the shares to restrictions and providing the criteria or dates on which such restrictions lapse. Restricted stock may vest over time,

based on performance criteria or other factors (including, without limitation, performance goals that are intended to comply with the performance-based compensation exception under Section 162(m) of the Code), as determined by the Committee at grant. Unless otherwise provided in an award agreement, restricted stock shall vest in equal installments over 3 years following the grant date.

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Restricted Stock Units. The 2004 Plan authorizes the Committee to award restricted stock units to employees and non-employee directors. A restricted stock unit is a unit of measurement equivalent to one share of our common stock that becomes nonforfeitable upon satisfying certain terms and conditions, as determined by the Committee. A restricted stock unit does not have any of the attendant rights of a shareholder, except it may have certain dividend rights as specified in the grant. A restricted stock unit may be distributed in our common stock and/or cash as determined by the Committee at the time of grant or if not specified at grant, at time of distribution. Restricted stock units may vest over time, based on performance criteria or other factors (including, without limitation, performance goals that are intended to comply with the performance-based compensation exception under Section 162(m) of the Code), as determined by the Committee at grant. Unless otherwise provided in an award agreement, restricted stock units will vest in equal installments over 3 years following the grant date.

Performance Shares and Performance Units. The 2004 Plan authorizes the Committee to grant performance shares to employees and non-employee directors entitling them to receive a fixed number of shares of our common stock or the cash equivalent, as determined by the Committee, upon the attainment of performance goals. The Committee may also grant performance units to employees and non-employee directors entitling them to receive a value payable in cash or shares of our common stock, as determined by the Committee, upon the attainment of performance goals (including, without limitation, performance goals that are intended to comply with the performance-based compensation exception under Section 162(m) of the Code).

Stock Awards. The 2004 Plan authorizes the Committee to grant stock awards to employees and non-employee directors. A stock award is an outright grant of our common stock or a grant of our common stock that is made in settlement of an award granted under another plan sponsored by us.

Other Stock-Based Awards. The 2004 Plan authorizes the Committee to grant awards of our common stock and other awards to employees and non-employee directors that are valued in whole or in part by reference to, or are payable in or otherwise based on, our common stock and may be granted either alone or in addition to or in tandem with stock options, restricted stock, performance shares or performance units.

Performance Goals

As noted above, performance-based awards granted under the 2004 Plan that are intended to satisfy the performance-based compensation exception under Section 162(m) of the Code will vest based on attainment of specified performance goals which have been established by the Committee. These performance goals will be based on one or more of the following criteria (including ratios in respect of certain of the following criteria) selected by the Committee: (i) the attainment of certain target levels of, or a specified increase in, EBITDA (earnings before income tax, depreciation and amortization) or the attainment of certain target levels of, or a specified decrease in, the ratio of debt to EBITDA; (ii) the attainment of certain target levels of, or a specified increase in, our enterprise value or value creation targets; (iii) the attainment of certain target levels of, or a percentage increase in, our after-tax or pre-tax profits including, without limitation, that attributable to our continuing and/or other operations; (iv) the attainment of certain target levels of, or a specified increase relating to, our operational cash flow or working capital, or a component thereof; (v) the attainment of certain target levels of, or a specified decrease relating to, our operational costs, or a component thereof; (vi) the attainment of a certain level of reduction of, or other specified objectives with regard to limiting the level of increase in all or a portion of bank debt or other of our long-term or short-term public or private debt or other similar financial obligations of our company, which may be calculated net of cash balances and/or other offsets and adjustments as may be established by the Committee; (vii) the attainment of a specified percentage increase in earnings per share or earnings per share from our continuing operations; (viii) the attainment of certain target levels of, or a specified percentage increase in, our net sales, revenues, net income or earnings before income tax or other exclusions; (ix) the attainment of certain target levels of, or a specified increase in, our return on capital employed or return on invested capital; (x) the attainment of certain target levels of, or a percentage increase

in, our after-tax or pre-tax return on shareholder equity; (xi) the attainment of certain target levels in the fair market value of our common stock; and (xii) the growth in the value of an investment in our common stock assuming the reinvestment of dividends.

In addition, such performance goals may be based upon the attainment by a subsidiary, division or other operational unit of our company of specified levels of performance under one or more of the measures described

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above. Further, the performance goals may be based upon the attainment by our company (or a subsidiary, division or other operational unit of our company) of specified levels of performance under one or more of the foregoing measures relative to the performance of other corporations. To the extent permitted under Section 162(m) of the Code (including, without limitation, compliance with any requirements for shareholder approval), the Committee may (i) designate additional business criteria upon which the performance goals may be based, (ii) modify, amend or adjust the business criteria specified in the 2004 Plan or (iii) incorporate in the performance goals provisions regarding changes in accounting methods, corporate transactions (including, without limitation, dispositions or acquisitions) and similar events or circumstances.

Change in Control

Upon a change in control of our company (as defined in the 2004 Plan), the Committee may (i) vest awards, (ii) terminate all outstanding awards; provided, that each participant will have a reasonable period of time to exercise all of his or her awards in full (without regard to any restrictions on exercisability), and/or (iii) terminate awards and provided that each participant will be entitled to an amount of cash equal to the excess of the change in control price (as defined in the 2004 Plan) of the shares of our common stock covered by such awards, over the aggregate exercise price of such awards.

Amendment and Termination

Notwithstanding any other provision of the 2004 Plan, our Board of Directors may at any time amend, in whole or in part, any or all of the provisions of the 2004 Plan, or suspend or terminate it entirely, retroactively or otherwise; provided, however, that, unless otherwise required by law, the rights of a participant with respect to awards granted prior to such amendment, suspension or termination, may not be impaired without the consent of such participant and, provided further, that shareholder approval shall be required for any amendment (i) that changes the class of individuals eligible to receive awards under the 2004 Plan, (ii) that increases the maximum number of shares of our common stock in the aggregate that may be subject to awards that are granted under the 2004 Plan (except as otherwise permitted under the 2004 Plan); (iii) if approval of such amendment is necessary to comply with federal or state law (including without limitation Section 162(m) of the Code and Rule 16b-3 under the Exchange Act) or with the rules of any stock exchange or automated quotation system on which our common stock may be listed or traded, or (iv) if such amendment eliminates a requirement provided in the 2004 Plan that our shareholders must approve an action to be undertaken under the 2004 Plan.

Nontransferability

Generally, awards granted under the 2004 Plan are not transferable by a participant other than by will or by the laws of descent and distribution, except that the Committee may provide that an award is transferable to certain family members.

Material U.S. Federal Income Tax Consequences

The following discussion of the principal U.S. federal income tax consequences with respect to options under the 2004 Plan is based on statutory authority and judicial and administrative interpretations as of the date of this proxy statement, which are subject to change at any time (possibly with retroactive effect) and may vary in individual circumstances. Therefore, the following is designed to provide a general understanding of the federal income tax consequences (state, local and other tax consequences are not addressed below). This discussion is limited to the U.S. federal income tax consequences to individuals who are citizens or residents of the U.S., other than those individuals who are taxed on a residence basis in a foreign country. The U.S. federal income tax law is technical and complex and the discussion below represents only a general summary.

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THE FOLLOWING SUMMARY IS INCLUDED HEREIN FOR GENERAL INFORMATION ONLY AND DOES NOT PURPORT TO ADDRESS ALL THE TAX CONSIDERATIONS THAT MAY BE RELEVANT. EACH RECIPIENT OF A GRANT IS URGED TO CONSULT HIS OR HER OWN TAX ADVISOR AS TO THE SPECIFIC TAX CONSEQUENCES TO SUCH RECIPIENT OF THE GRANT AND THE DISPOSITION OF COMMON STOCK.

Incentive Stock Options.

Under current federal income tax laws, the grant or exercise of an ISO generally has no income tax consequences for the optionee or us. However, the amount by which the fair market value of our common stock acquired pursuant to the exercise of an ISO exceeds the exercise price is an adjustment item for purposes of alternative minimum tax.

The aggregate fair market value of our common stock (determined at the time of grant) with respect to which ISOs can be exercisable for the first time by an optionee during any calendar year cannot exceed \$100,000. Any excess will be treated as a non-qualified stock option.

The sale of our common stock received pursuant to the exercise of an option that satisfied all of the ISO requirements, as well as the holding period requirement described below, will result in a long-term capital gain or loss equal to the difference between the amount realized on the sale and the exercise price. To receive ISO treatment, an optionee must be an employee of our company (or any subsidiary) at all times during the period beginning on the date of the grant of the ISO and ending on the day three months before the date of exercise, and the optionee must not dispose of our common stock purchased pursuant to the exercise of an option either (i) within two years after the option is granted, or (ii) within one year after the date of exercise. Any gain or loss realized on a subsequent disposition of the shares will be treated as long-term capital gain or loss (depending on the applicable holding period). The Company will not be entitled to a tax deduction upon the exercise of an ISO, nor upon a subsequent disposition of the shares of our common stock, unless the disposition occurs prior to the expiration of the holding period described above.

In general, if the optionee does not satisfy these holding period requirements, any gain equal to the difference between the exercise price and the fair market value of our common stock at exercise (or, if a lesser amount, the amount realized on disposition over the exercise price) will constitute ordinary income. In the event of such a disposition before the expiration of either holding period described above, we will be entitled to a deduction at that time equal to the amount of ordinary income recognized by the optionee. Any gain in excess of the amount recognized by the optionee as ordinary income would be taxed to the optionee as short-term or long-term capital gain (depending on the applicable holding period).

Non-Qualified Stock Options.

In general, an optionee will recognize no taxable income upon the grant of a non-qualified stock option and we will not receive a deduction at the time of such grant. Upon exercise of a non-qualified stock option, an optionee generally will recognize ordinary income in an amount equal to the excess of the fair market value of our common stock on the date of exercise over the exercise price. Upon a subsequent sale of our common stock by the optionee, the optionee will recognize short-term or long-term capital gain or loss, depending upon his holding period for the Common Stock. The Company will generally be allowed a deduction equal to the amount recognized by the optionee as ordinary income.

Section 162(m) of the Code.

Section 162(m) of the Code denies a deduction to any publicly held corporation for compensation paid to certain covered employees in its taxable year to the extent that such compensation exceeds \$1,000,000. Covered employees are a company's chief executive officer on the last day of the taxable year and any other individual whose compensation is required to be reported to shareholders in its proxy statement under the Exchange Act by reason of such employee being among the four highest compensated officers for the taxable year (other than the

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chief executive officer). Compensation paid under certain qualified performance-based compensation arrangements, which (among other things) provide for compensation based on preestablished performance goals established by a compensation committee that is comprised solely of two or more outside directors, is not considered in determining whether a covered employee's compensation exceeds \$1,000,000. It is intended that certain awards under the 2004 Plan will satisfy these requirements so that the income recognized in connection with awards will not be included in a covered employee's compensation for the purpose of determining whether such individual's compensation exceeds \$1,000,000.

Parachute Payments.

In the event that the payment of any award under the 2004 Plan is accelerated because of a change in ownership (as defined in Code Section 280G(b)(2)) and such payment of an award, either alone or together with any other payments made to the participant, constitute parachute payments under Section 280G of the Code, then subject to certain exceptions, a portion of such payments would be nondeductible to the company and the participant would be subject to a 20% excise tax on such portion of the payment.

Tax Consequences for Non-U.S. Taxpayers.

Tax consequences for non-U.S. taxpayers will vary depending upon the tax laws of foreign jurisdictions.

Future Plan Awards.

Because future awards under the 2004 Plan will be based upon prospective factors including the nature of services to be rendered and a recipient's potential contributions to the success of our company, actual awards cannot be determined at this time.

The affirmative vote of the majority of the votes cast by the holders of our common stock present or represented by proxy and voting on the matter is required to approve this Proposal 6.

Our Board of Directors believes that it is in best interests of our company and the best interests of our shareholders to approve our 2004 Stock Incentive Plan, and unanimously recommends that you vote FOR this Proposal 6.

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OTHER INFORMATION ABOUT THE TRANSACTION

Completion of the Transaction; Effective Time; Timing

The purchase agreement provides that the issuance of shares of our common stock in connection with our proposed sale of units to Coconut Palm Capital Investors II, Ltd., a Florida limited partnership (Coconut Palm) will be effected if our shareholders vote to approve and authorize Proposals 1, 2 and 3 set forth in this proxy statement (such proposals are collectively referred to as the Transaction), and other conditions stated in the purchase agreement have been satisfied. If the shareholders vote for the election of the nominees described in Proposal 4, the effective time of the election of the Coconut Palm nominees will be the date on which the transactions contemplated by the purchase agreement are completed. We have also agreed to allow Coconut Palm to nominate 2 additional directors to fill certain vacancies on our Board of Directors, including the 1 additional newly created vacancy if our shareholders vote to approve Proposal 2 in this proxy statement, and the vacancy created by Mr. Oppenheim 's resignation upon the closing of the Transaction. Each of the nominees will be elected by a majority vote of our Board of Directors within 30 days of the creation of each of the respective vacancies, as provided by our bylaws.

We have agreed that we will file with the Securities and Exchange Commission a registration statement registering the resale of the shares of common stock and the shares of common stock underlying the warrants issued to Coconut Palm not later than 60 days after the closing of the Transaction. We have further agreed to use our reasonable best efforts to cause this registration statement to become effective no later than 60 days after it has been filed with the Securities and Exchange Commission. For more information, see Registration Rights on page 47.

Interests of Certain Persons in the Transaction

Members of our management team and our Board of Directors may have interests in the Transaction that are in addition to their interests as our shareholders generally. Our Board of Directors was aware of these interests and considered them in approving the Transaction.

Additional Registration Rights. Our Chairman, Michael D. Herman, and, if Proposal 5 is approved, 3 other members of our Board of Directors, Arnold Heggstad, Ph.D., Gerard P. Laheney, and Steven P. Oppenheim, will be granted registration rights which will permit them to register for resale their shares of common stock (and the shares of our common stock underlying their options), along with and to the same extent as, the shares of our common stock (and the shares of our common stock underlying the warrants) being acquired by Coconut Palm. For more information, see Registration Rights on page 47.

Executive Employment Agreements. In order to continue the growth of our high frequency single sideband communications business, each of: (i) James E. Laurent, our current President and Chief Executive Officer; (ii) Synnott B. Durham, our current corporate Secretary and Chief Financial Officer; and (iii) Henry A. Budde, our current Vice President of Operations, will enter into an employment agreement with us, which, by its terms, will be effective upon, and only upon, the closing of the Transaction. Mr. Laurent will serve as the President of the high frequency single sideband communications business, and we anticipate the aggregate compensation to be paid to Mr. Laurent to be approximately \$152,500 in annual salary. Mr. Durham will serve as the Vice President of Finance of the high frequency single sideband communications business, and we anticipate the aggregate compensation to be paid to Mr. Durham to be approximately \$125,000 in annual salary. Mr. Budde will serve as the Vice President of Operations of the high frequency single sideband communications business, and we anticipate the aggregate compensation to be paid to Mr. Budde to be approximately \$125,000 in annual salary. Messrs. Laurent, Durham and Budde will also be entitled to other employee benefits to the same extent as our other similarly situated senior executives participate after the closing of the Transaction. In addition, we anticipate that each of Messrs. Laurent, Durham and Budde will be

granted 20,000 options at the beginning of each year during the term of their respective employment agreements, which such options will be granted under the 2004 Plan (provided our shareholders approve Proposal 6) and will vest and become exercisable at the end of each year during the term of their respective employment agreements. Each of the employment agreements will have a term of 2 years. If we terminate any employment agreement without cause, we will be required to pay such employee severance payments at the rate of his salary in effect on the date of termination for a period of 6 months and his options will vest and become exercisable upon the effective date of such termination.

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Description of the Purchase Agreement

The following summary of terms of the purchase agreement does not purport to be complete and is qualified in its entirety by reference to the complete text of the purchase agreement, which is included as Annex B to this proxy statement. We urge you to carefully read the purchase agreement in its entirety.

Purchase Price

If our shareholders approve the Transaction, subject to specified conditions, we will issue and sell to Coconut Palm up to a total of 5,000,000 units at a purchase price of \$5.00 per unit as follows: (i) 3,000,000 units for an aggregate purchase price of \$15,000,000; and (ii) at the option of Coconut Palm, up to an additional 2,000,000 units for an aggregate purchase price of up to \$10,000,000.

Under the purchase agreement, Coconut Palm is obligated to purchase only 3,000,000 units at the closing, subject to the satisfaction of specified conditions. Coconut Palm has the right, but not the obligation, to elect to purchase up to 2,000,000 additional units within 5 days prior to the closing of the Transaction. The closing of the purchase of the 2,000,000 additional units is anticipated to occur at the same time as the closing of the 3,000,000 units; however, if, despite our best efforts, we and Coconut Palm are unable to close on the purchase of the 2,000,000 additional units at such time, then we and Coconut Palm may mutually agree on a closing date which may not be later than 7 business days after the closing of the 3,000,000 units.

Each unit will consist of the following:

one share of our common stock;

a warrant to purchase one additional share of our common stock, at an exercise price of \$6.00 per share, which will be immediately exercisable and will expire after three years; and

a warrant to purchase one additional share of our common stock, at an exercise price of \$7.00 per share, which will be immediately exercisable and will expire after five years.

The aggregate purchase price is to be paid through a wire transfer to an account designated by us.

Coconut Palm has advised us that, at some time after the closing of the Transaction and from time to time, it may separate the shares of common stock and warrants comprising the units into the securities that comprise them. There are no prohibitions against this separation in the transaction documents so long as the separation and subsequent distribution is in compliance with applicable securities laws.

Representations and Warranties

The purchase agreement contains representations and warranties provided by Coconut Palm as to the following:

opportunity to obtain and acquire access to information in order to evaluate the proposed investment;

opportunity to ask questions concerning the terms and conditions of the purchase agreement and the shares;

understanding of any risks inherent in the investment;

level of financial sophistication;

lack of intent to acquire the shares with a view to distribution of the shares to anyone;

qualifications as an accredited investor as this term is used in Rule 501 of the Securities Act of 1933, as amended;

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awareness of restrictions on the transferability of the shares;

awareness of the application of the securities laws to future resales of the shares;

authorization, execution and enforceability of the purchase agreement;

lack of reliance on any advertisement or other form of public solicitation in participating in the purchase of the shares;

acknowledgement of our reliance on representations and warranties;

lack of a conflict caused by the execution, delivery and performance of the purchase agreement; and

compliance with applicable securities laws in connection with the Transaction and any subsequent transfers of the units or securities comprising the units.

The purchase agreement also contains representations and warranties provided by us as to the following:

organization, good standing and capitalization;

authorization, execution and enforceability of the purchase agreement;

legality of the issuance of the units and the securities comprising the units;

lack of a conflict caused by the execution, delivery and performance of the purchase agreement;

availability and accuracy of reports and other documents filed with the Securities and Exchange Commission;

financial statements;

subsidiaries;

lack of material adverse effect since June 30, 2004;

compliance with environmental laws;

rights to intellectual property;

compliance with applicable securities laws and American Stock Exchange requirements in connection with the Transaction;

compliance with applicable tax laws;

compliance with applicable permit and licensing regulations;

insurance;

real estate;

compliance with the Foreign Corrupt Practices Act and similar laws;

solvency;

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extension of loans to officers and directors;

compliance with the Sarbanes-Oxley Act of 2002;

eligibility to file with the Securities and Exchange Commission a registration statement on Form S-3 for purposes of registering the resale of the shares of common stock underlying the units; and

lack of necessity to register under the Securities Act of 1933 the issuance of the units to Coconut Palm.

Conditions to Closing

The closing of the Transaction contemplated by the purchase agreement is subject to the satisfaction or waiver of the following conditions: (i) shareholder approval of the Transaction, including expanding our Board of Directors from 5 to 7 members, amending our Articles of Incorporation and election of the Coconut Palm nominees, (ii) the absence of a withdrawal of the approval of the Transaction by our Board of Directors in the event our Board of Directors determines this withdrawal is required by its fiduciary duties to our shareholders, (iii) receipt of necessary governmental and/or regulatory filings, approvals or required third party consents of both parties, (iv) receipt of satisfactory legal opinions of our counsel and counsel for Coconut Palm, (v) the absence of the occurrence of any material adverse event affecting us, our business, Coconut Palm or Coconut Palm's principals, and the filing with the Secretary of State of Florida by us of Articles of Amendment to our Articles of Incorporation effecting the change of our corporate name to Sunair, Inc., authorizing our company to conduct any business to the extent permitted by law and increasing the number of our authorized shares of capital stock to 108,000,000 shares, of which 100,000,000 shares will be common stock and 8,000,000 shares will be preferred stock, (vi) we shall have entered into employment agreements with Donald K. Karnes, David M. Slott and John J. Hayes, provided such individuals have not been enjoined from performing the contemplated services for the Pest and Termite Control Services Division, and (vii) we shall have received executed employment agreements from our President and Chief Executive Officer, James E. Laurent and our Chief Financial Officer, Synnott B. Durham.

Covenants

The purchase agreement also contains covenants that require us to:

Adopt and pursue the following strategies and objectives:

- o Diversifying our operations into the pest and termite control services sector;
- o Targeting potential acquisitions of pest and termite control services companies in the United States and its territories that would provide a critical mass from which we may grow organically and through acquisitions;
- o Financing the growth of our new Pest and Termite Control Services Division by accessing the equity and debt capital markets to the extent access to such markets is deemed to be favorable by our Board of Directors; and
- o Use of the proceeds solely in furtherance of the above strategies and objectives and any other expenditures that may be reasonably incidental to the furtherance of these strategies.

Nominate Richard C. Rochon and Mario B. Ferrari for election to our Board of Directors.

Reserve a sufficient number of shares for issuance upon the exercise of the warrants.

Submit the Transaction for approval at the Annual Meeting of Shareholders.

Comply with applicable federal and state securities laws and the rules and regulations of the American Stock Exchange with respect to the issuance of the securities comprising the units.

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Not enter into any transactions with our affiliates prior to the closing of the Transaction, except those transactions which have been disclosed to Coconut Palm or which Coconut Palm agrees to in writing or which are permitted by our Code of Ethical Conduct or applicable law and the rules and regulations of the Securities and Exchange Commission and the American Stock Exchange.

Not solicit or negotiate competing proposals unless our Board of Directors determines these activities are required by its fiduciary duties to our shareholders.

Pay or reimburse all fees and expenses incurred by Coconut Palm in connection with the Transaction, including investment banking, legal, accounting, attorneys, consultants and other professional fees.

Enter into employment agreements with our current President and Chief Executive Officer, James E. Laurent, and our current corporate Secretary and Chief Financial Officer, Synnott B. Durham, which such executive officers will continue to oversee our high frequency single sideband communications business.

Enter into an employment agreement with Donald K. Karnes, as our President and Chief Executive Officer, and employment agreements with David M. Slott and John J. Hayes, as executive officers of the newly created Pest and Termite Control Services Division.

Enter into a management services agreement with an affiliate of Coconut Palm, RPC Financial Advisors, LLC, to provide management services for our Pest and Termite Control Services Division.

Divest ourselves of certain non-core assets acquired in connection with our purchase of: (i) Percipia, Inc. and its wholly-owned subsidiary Percipia Networks, Inc.; and (ii) the assets of Telecom FM.

Registration Rights

The purchase agreement provides that the issuance of the shares of common stock or the shares underlying the warrants which comprise the units will not be registered under the Securities Act of 1933, as amended, and that, accordingly, the shares will not be freely tradable, and will be restricted securities with associated limitations on the ability of Coconut Palm to transfer these shares. However, we have agreed to file a registration statement on Form S-3 to register the resale of both the shares of common stock issued to Coconut Palm under the purchase agreement and any shares of common stock issuable upon exercise of the warrants issued to Coconut Palm under the purchase agreement. We are required to file this registration statement with the Securities and Exchange Commission, as soon as practicable, but no later than 60 days after the closing of the Transaction. Furthermore, Coconut Palm has agreed to allow us to register for resale the following shares, to the same extent as the shares of our common stock being acquired by (and the shares of our common stock underlying the warrants being acquired by) Coconut Palm: (i) certain shares of our common stock held by our Chairman, Michael D. Herman, up to an amount equal to the number of shares purchased by Coconut Palm; (ii) 190,000 shares of our common stock issued in connection with our acquisition of Percipia, Inc. and its wholly-owned subsidiary Percipia Networks, Inc.; and (iii) if Proposal 5 is approved, the 60,000 shares of our common stock issuable upon conversion of the stock options issued to 3 of our current directors.

Our Board of Directors determined Mr. Herman and 3 other members of our Board of Directors, Arnold Heggstad, Ph.D., Gerard P. Laheney and Steven P. Oppenheim, should also be granted this ability due to the contributions these individuals have made to our company.

The registration rights agreement allows for specified deferral periods in which we may delay the filing or effectiveness of the registration statement or the disclosure of material non-public information in the event the filing, effectiveness or disclosure is determined to be materially disadvantageous to us. We are entitled to no more than two

deferral periods in any twelve-month period and any deferral period may not exceed 45 days.

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Indemnification and Insurance

We and Coconut Palm each agree to indemnify and hold harmless the other for any losses we incur due to (i) untrue statements of a material fact or omissions to state a material fact required to make the statements made not misleading provided to each other for purposes of filing the registration statement we are required to file or (ii) the breach of any representation, warranty, covenant or agreement in the purchase agreement. This indemnification obligation is subject to a \$15,000,000 limit on liability as well as a \$100,000 threshold, below which neither party is obligated to satisfy any liability.

Relationship of Richard C. Rochon and Mario B. Ferrari to Coconut Palm Capital Investors II, Ltd.

Coconut Palm Capital Investors II, Ltd. (Coconut Palm) has informed us that: (i) Richard C. Rochon is the sole stockholder of Coconut Palm Capital Investors II, Inc., which is the general partner of Coconut Palm; (ii) Mr. Rochon and Mario B. Ferrari are both officers and directors of, Coconut Palm; (iii) Coconut Palm is an affiliate of Royal Palm Capital Partners, LLLP (Royal Palm); (iv) Messrs. Rochon and Ferrari are officers of Royal Palm; (v) and Royal Palm is a private equity investment and management firm led by Mr. Rochon. Messrs. Rochon and Ferrari have informed us that they both expect to receive distributions of units from Coconut Palm under the terms of the internal organizational documents of Coconut Palm. Coconut Palm has informed us that certain of the warrants to be issued to these persons are for purposes of providing management and other services to Coconut Palm and to provide strategic oversight of our new Pest and Termite Control Services Division strategy. In performing these services, these individuals will also be assisting us, and we believe that we will also be a beneficiary of these services. As to Richard Rochon and Mario Ferrari, see Nominees on page 31.

Coconut Palm has also informed us that Messrs. Rochon and Ferrari are expected to retain the power to vote and dispose of the securities remaining with Coconut Palm and are thus attributed beneficial ownership of all of these securities. Coconut Palm has agreed that any distributions it makes to anyone, including its partners, must be in compliance with applicable securities laws. We will sell the units to Coconut Palm at fair value and record the cash received for the warrants as additional-paid-in-capital at the time of closing.

Description of the Warrant Agreements

The following summary of terms of the warrant agreements does not purport to be complete and is qualified in its entirety by reference to the complete text of the warrant agreements, a form of which is included as Annex E to this proxy statement. We urge you to carefully read the form of warrant agreement in its entirety.

The form of warrant agreement contemplates two tranches of warrants, all to be issued as part of the units. The tranches differ only in terms of their respective exercise prices and terms and specified anti-dilution adjustments. One tranche of warrants which is exercisable for 1 share of our common stock for every unit has an exercise price of \$6.00 per share and a term of 3 years. A second tranche of warrants which is exercisable for 1 share of our common stock for every unit has an exercise price of \$7.00 per share and a term of 5 years.

The warrants provide for two forms of exercise:

(i) a cash exercise whereby the holder exercises the warrant by paying to us the product of the number of shares of our common stock underlying the warrant and the exercise price per share of the warrant; and

(ii) a broker-assisted exercise in which the holder shall be permitted to exercise a portion of the warrants, sell the underlying shares of our common stock using a broker and immediately apply the proceeds from the exercise to

pay the exercise price of the exercised warrants as well as the exercise price of other warrants which the holder desires to exercise. We agree in the warrant to allow the issuance of the shares of common stock necessary to effect this broker-assisted exercise notwithstanding the fact that we would not receive the cash proceeds until after the sale of the underlying shares of common stock, subject to compliance with applicable law. The holder of the warrant agrees to indemnify us for any damages we incur due to the failure of the broker to remit these proceeds to us.

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The broker-assisted exercise may only be effected after six months have elapsed since the closing of the Transaction.

The warrant provides that the exercise price shall be subject to adjustment, on a fully-diluted basis, in the event of any issuances of common stock (to a party other than the holder) at a price less than, or options and other convertible securities bearing an exercise price less than, the closing sales price of our common stock on the date of this subsequent issuance unless the issuance (i) has been approved by our Board of Directors, including one of Coconut Palm's nominees, (ii) consists of an issuance of options under our stock option plan, or (iii) this issuance is in connection with any acquisition of another corporation by us if this acquisition is approved by our Board of Directors. This anti-dilution adjustment is effective only for the first 180 days following the closing of the Transaction and, with respect to convertible securities bearing an exercise price less than the closing sales price, applies only to the tranche of warrants bearing an exercise price equal to \$6.00 per share. The warrant also provides for other customary anti-dilution adjustments to the exercise price in the event of stock splits, stock dividends, recapitalizations, reorganizations, reclassifications, distributions and business combinations, as well as adjustments in the event of cash dividends and other specified distributions.

The warrant provides that we may not effect any business combination unless the surviving company in this business combination assumes our obligations under the warrant.

Description of the Voting Agreement

The following summary of terms of the voting agreement between Coconut Palm and Michael Herman does not purport to be complete and is qualified in its entirety by reference to the complete text of the voting agreement, which is included as Annex F to this proxy statement. We urge you to carefully read the voting agreement in its entirety.

In connection with the purchase agreement, Coconut Palm and our Chairman, Michael D. Herman, who beneficially owns approximately 51% of our currently outstanding common stock, entered into a voting agreement, dated November 17, 2004. Pursuant to the terms of the voting agreement, Mr. Herman agreed to vote his beneficially owned shares of our common stock in favor of the issuance and sale of the units to Coconut Palm at the Annual Meeting of Shareholders and to grant Coconut Palm an irrevocable proxy to vote such shares of common stock: (i) in favor of the issuance and sale of the units to Coconut Palm, as contemplated by the purchase agreement; and (ii) against any actions or approval that could compete with or could serve to materially interfere with, delay, discourage adversely or inhibit the timely consummation of the issuance and sale of the units to Coconut Palm, as contemplated by the purchase agreement. The voting agreement also prohibits Mr. Herman from selling or transferring the shares of our common stock beneficially owned by him other than in certain permitted circumstances. The voting agreement contains customary representations regarding the beneficial ownership of our common stock by Mr. Herman. The voting agreement terminates upon the earlier to occur of: (i) the consummation of the transactions contemplated by the purchase agreement; (ii) any termination of the purchase agreement in accordance with its terms; or (iii) our Board of Directors' withdrawal of its approval of the transactions contemplated by the purchase agreement pursuant to Section 8(n) of the purchase agreement.

Description of the Management Services Agreement

We have also agreed, upon the closing of the Transaction, to enter into a 5 year management services agreement with an affiliate of Coconut Palm, RPC Financial Advisors, LLC (RPC), to provide management services for our Pest and Termite Control Services Division, pursuant to which we will pay a management fee during the first year of an amount equal to 1/16 times the aggregate purchase price paid for the units by Coconut Palm. Following the first year

and thereafter, the management fee will be equal to 1% of the gross revenues from operations of our new Pest and Termite Control Services Division. Certain officers and directors of RPC will also serve as members of our Board of Directors upon the closing of the Transaction.

Pursuant to the management services agreement, RPC will provide us with certain services including: (i) establishing certain office, accounting and administrative procedures; (ii) assisting us in trying to obtain financing relating to business operations and acquisitions; (iii) helping us in developing and implementing advertising, promotional and marketing programs; (iv) advising us with respect to securities matters and future acquisitions and

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dispositions; (v) assisting us in developing tax planning strategies; and (vi) formulating risk management policies. After the initial term of 5 years, the management services agreement shall be automatically renewed for successive 1 year terms, unless either RPC or we terminate the agreement upon 30 days notice. The management services agreement may be terminated at any time upon our mutual agreement with RPC, and may also be terminated for cause if any breach or default under the agreement is not cured within 30 days after receipt of written notice of such breach or default.

Consequences of the Proposals

While the proposals in this proxy statement are being listed separately for purposes of voting, Proposals 1, 2 and 3 are all interdependent. Accordingly, obtaining the requisite shareholder approval for each such proposal is a condition precedent to the effectiveness of the other such proposals. In addition, that portion of Proposal 4 relating to the election of Messrs. Rochon and Ferrari to our Board of Directors, the resignation of Mr. Oppenheim from our Board of Directors and the filling of the 2 vacancies by Coconut Palm nominees (including the 1 additional newly created vacancy if Proposal 2 is approved by our shareholders, and the vacancy created by Mr. Oppenheim's resignation), are each contingent upon the closing of the Transaction. If the Transaction does not close: (i) the election of Messrs. Rochon and Ferrari to our Board of Directors will not become effective; (ii) Mr. Oppenheim will not resign from our Board of Directors; and (iii) Coconut Palm will not fill any vacancies on our Board of Directors. That portion of Proposal 4 relating to the election of Messrs. Herman, Heggstad, Laurent and Oppenheim, Proposal 5, relating to the issuance of an aggregate of 60,000 options to purchase shares of our common stock to 3 of our current directors outside of our existing stock option plan, and Proposal 6, relating to the approval of our 2004 Stock Incentive Plan, are each independent of the other proposals in this proxy statement and will become effective, if approved, irrespective of whether our shareholders approve the Transaction.

Further, if our shareholders fail to approve Proposals 1, 2 and 3 set forth in this proxy statement, we will be unable to issue shares of our common stock and warrants to purchase shares of our common stock to Coconut Palm and the Transaction contemplated by the purchase agreement will not be completed. In addition, because the election of Messrs. Rochon and Ferrari and the resignation of Mr. Oppenheim are conditioned upon the closing of the Transaction, Messrs. Rochon and Ferrari will not be elected to our Board of Directors, Mr. Oppenheim will not resign from our Board of Directors, and no vacancies will be filled by Coconut Palm, if Proposals 1, 2 and 3 are not approved. If we were to effect the sale and issuance of our shares of common stock to Coconut Palm in accordance with the terms of the purchase agreement in the absence of shareholder approval our common stock could be delisted from the American Stock Exchange due to the violation of 20% Rule. Consequently, obtaining this approval is a condition to the closing of the Transaction under the purchase agreement. In addition, if the foregoing fails to occur, we will not launch our new Pest and Termite Control Services Division, we will not increase the size of our Board of Directors from 5 to 7 members, and our Articles of Incorporation will not be amended. That portion of Proposal 4 relating to the election of Messrs. Herman, Heggstad, Laurent and Oppenheim, and Proposals 5 and 6 are each independent of the other proposals in this proxy statement and will become effective, if approved, irrespective of whether our shareholders approve the Transaction.

If our shareholders approve Proposals 1, 2, 3 and 4, an aggregate of up to 5,000,000 additional shares of our common stock will be issued and outstanding and warrants to purchase up to an additional 10,000,000 additional shares of our common stock will be issued and outstanding, our Board of Directors will be increased from 5 to 7 members, the proposed amendments to our Articles of Incorporation will be in effect and the nominees (including the Coconut Palm nominees) will be elected to our Board of Directors. The additional shares of our common stock issued by us will dilute the percentage ownership of existing shareholders of our common stock and would, absent any further factors, reduce our earnings per share. The perceived risk of dilution may cause our shareholders to sell their shares, which would contribute to a downward movement in the market price of our common stock. Moreover, the

perceived risk of dilution and the resulting downward pressure on the stock price could encourage third parties to engage in short sales of our common stock. By increasing the number of shares offered for sale, material amounts of short selling could further contribute to progressive price declines in our common stock. If the market price of our common stock does decline, this could further accelerate sales of our common stock. Ultimately, however, the extent of dilution to our shareholders with respect to earnings per share will depend on the actual results we achieve.

Coconut Palm may acquire up to 5,000,000 shares of our common stock in the Transaction and, provided Coconut Palm purchases all 5,000,000 shares of our common stock, will be entitled to purchase up to an additional

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10,000,000 shares of our common stock upon exercise of the warrants. Based on that number and the number of shares of our common stock outstanding on [January 7, 2005], the record date, if Coconut Palm: (i) purchases only the 3,000,000 units, Coconut Palm will acquire approximately 43% of our common stock outstanding immediately after the closing of the Transaction; (ii) exercises its option to purchase the 2,000,000 additional units, Coconut Palm will acquire approximately 56% of our common stock outstanding immediately after the closing of the Transaction. In addition, Coconut Palm will be entitled, on a fully diluted basis, to acquire up to: (i) 69% of our common stock outstanding immediately after the closing of the Transaction, upon exercise of the 6,000,000 warrants acquired in connection with the purchase of the 3,000,000 units; and (ii) 79% of our common stock outstanding immediately after the closing of the Transaction upon exercise of an additional 4,000,000 warrants, if Coconut Palm exercises its option to purchase the 2,000,000 additional units. If Coconut Palm were to: (i) exercise its option to purchase up to 2,000,000 additional units; (ii) exercise the warrants acquired with the 3,000,000 units or (iii) exercise the warrants acquired if it exercises its option to purchase the 2,000,000 additional units, it would have enough shares of our common stock to control our company.

Coconut Palm has advised us that, at some time after the closing of the Transaction and from time to time, it may separate the shares of common stock and warrants comprising the units into the securities that comprise them. There are no prohibitions against this separation in the transaction documents so long as the separation and subsequent distribution is in compliance with applicable securities laws.

Future Plans

Upon completion of the Transaction, we will implement our new Pest and Termite Control Services Division. We intend to use the proceeds from the sale of the units to fund initial acquisitions that have operations in the pest and termite control services sector to form the Pest and Termite Control Services Division. If we are successful in implementing this strategy, our new Pest and Termite Control Services Division will become our dominant operation. This will represent a fundamental shift in the nature of our business. In addition, the holdings of Coconut Palm on a fully diluted basis, taking into account exercise of all the warrants, would amount to control over us. As Coconut Palm is a partnership, it may ultimately distribute the units to its partners and/or principals, which may have the effect of eliminating any control Coconut Palm acquires. Coconut Palm has not informed us of any intent to distribute any of the units, or any portion of the securities comprising the units, to anyone other than Messrs. Rochon and Ferrari. Coconut Palm has agreed that any distributions it makes to anyone, including its partners, must be in compliance with applicable securities laws.

We have also agreed, upon completion of the Transaction, to use our best efforts to enter into a definitive agreement as soon as practicable to divest ourselves of certain non-core assets acquired in connection with our purchase of: (i) Percipia, Inc. and its wholly-owned subsidiary Percipia Networks, Inc.; and (ii) the assets of Telecom FM, at a purchase price equal to the amount we paid for such assets plus the amount of any intercompany debt incurred and advances made in connection with such purchases. The non-core assets are currently held in separate wholly-owned subsidiaries.

Use of Proceeds

The proceeds from the issuance and sale of up to 5,000,000 units to Coconut Palm will be used to implement the following strategies regarding formation of our new Pest and Termite Control Services Division:

Diversifying our operations into the pest and termite control services sector;

Targeting potential acquisitions, or initial acquisitions, of pest and termite control services companies in the United States and its territories that would provide a critical mass from which we may grow organically and through acquisitions; and

Expenditures that are reasonably incidental to the furtherance of these strategies.

We anticipate that the initial acquisition(s) will be financed with a combination of equity and debt, with \$1,000,000 million of our existing cash and the investment made by Coconut Palm in this Transaction. Covenants in

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the purchase agreement require us to pursue these specified proposed strategies in order to utilize the investment of Coconut Palm to begin our entry into the pest and termite control services industry. We are currently exploring avenues towards effecting these initial acquisitions; however, we cannot assure you that these efforts will result in the successful implementation of our new Pest and Termite Control Services Division.

We also expect to use the proceeds from any exercise of the warrants for similar purposes.

Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995, or the Reform Act, provides a safe harbor for forward-looking statements made by or on behalf of our Company. We and our representatives may, from time to time, make written or verbal forward-looking statements, including statements contained in this proxy statement. Generally, the inclusion of the words believe, expect, intend, estimate, anticipate, will, and similar expressions identify statements that constitute 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 and that are intended to come within the safe harbor protection provided by those sections. All statements addressing operating performance, events, or developments that we expect or anticipate will occur in the future, including statements relating to sales growth, earnings or earnings per share growth, and market share, as well as statements expressing optimism or pessimism about future operating results, are forward-looking statements within the meaning of the Reform Act.

Table of Contents**CURRENT DIRECTORS AND EXECUTIVE OFFICERS**

The following table sets forth our current directors and executive officers. Our directors are elected annually and hold office until their death, resignation, retirement, removal, disqualification, or the next Annual Meeting of Shareholders or until their successors are duly elected and qualified. Our executive officers serve at the discretion of our Board of Directors. There is no family relationship between or among any of our directors and executive officers. Our current Board of Directors consists of five persons.

Name	Age	Position
Henry A. Budde	52	Vice President of Operations
Synnott B. Durham	63	Chief Financial Officer
Michael D. Herman	47	Chairman of the Board
Arnold Heggstad, Ph.D.	61	Director
Gerard P. Laheney	66	Director
James E. Laurent	68	Director, President and Chief Executive Officer
Steven P. Oppenheim	58	Director

Below is a summary of the business experience of our executive officers who do not serve on our Board of Directors. The business experience of the nominees to our Board of Directors appears under the caption "Nominees" beginning on page 31.

Henry A. Budde, 52, has served as our Vice President of Operations since September 2000 directing product development, systems engineering and product manufacturing. Mr. Budde previously served as our Vice President of Engineering beginning in January 1999 and prior to that held various product development and engineering program management positions since 1974.

Synnott B. Durham, 63, has served as our Corporate Secretary since 2003, our Chief Financial Officer since 1994, and has held various other executive roles with our company since 1979. Mr. Durham received his B.B.A in Accounting from Florida International University.

Table of Contents**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth as of the record date (or such other date indicated in the footnotes below), the number of shares beneficially owned prior to the Transaction, the number of shares beneficially owned immediately after completion of the Transaction, the percentage of ownership of our common stock prior to the Transaction and the percentage ownership of our common stock immediately after completion of the Transaction, assuming Coconut Palm acquires all 5,000,000 units, by the following: (i) each person known to us to own beneficially more than 5 percent of the outstanding shares of our common stock; (ii) each of our current directors (but does not take into account any options that would be granted to that nominee if Proposal 5 is approved at the Annual Meeting of Shareholders); (iii) each nominee for director (but does not take into account any options that would be granted to that nominee if Proposal 5 is approved at the Annual Meeting of Shareholders); (iv) each of our executive officers who had annual salary and bonus for 2004 in excess of \$100,000, referred to in this proxy statement as the Named Executive Officers, including our President and Chief Executive Officer; and (v) all of our directors and executive officers as a group.

	Common Stock Beneficially Owned (1)(2)			
	Prior to Transaction		After Transaction	
	Shares	Percent	Shares	Percent
Michael D. Herman ⁽³⁾	2,056,700	51.3%	2,056,700	10.8%
Arnold Heggstad	8,000	*	8,000	*
Gerard P. Laheney	4,000	*	4,000	*
James E. Laurent	51,005(4)	1.3%	51,005	*
Steven P. Oppenheim	0	*	0	*
Synnott B. Durham	46,900(5)	1.2%	46,900	*
Henry A. Budde	50,000(6)	1.2%	50,000	*
Richard C. Rochon ⁽⁷⁾	0	*	15,000,000	78.9%
Mario B. Ferrari ⁽⁷⁾	0	*	15,000,000	78.9%
All directors, director-nominees and executive officers as a group (9 persons)	2,216,605	55.2%	17,216,605	90.5%

* Less than 1%.

(1) Except as otherwise indicated, the address of each person named in this table is c/o Sunair Electronics, Inc., 3005 S.W. Third Avenue, Fort Lauderdale, Florida 33315.

(2) Unless otherwise noted, all persons have sole voting and investment power with respect to shares owned by them.

(3) The 2,056,700 shares of our common stock beneficially owned by Mr. Herman are subject to a voting agreement, under the terms of which Mr. Herman has agreed to vote such shares in favor of the Transaction.

(4) Includes 40,000 shares issuable upon exercise of currently exercisable options.

(5) Includes 46,900 shares issuable upon exercise of currently exercisable options.

(6) Includes 49,500 shares issuable upon exercise of currently exercisable options.

(7) Shares consist of all shares purchased by Coconut Palm (including all shares underlying warrants, all of which will be exercisable upon delivery). Assumes beneficial ownership of such shares is attributed to Messrs. Rochon and Ferrari. Messrs. Rochon and Ferrari disclaim beneficial ownership of these shares. The address for Messrs. Rochon and Ferrari is c/o Coconut Palm Capital Investors II, Ltd., 595 South Federal Highway, Boca Raton, Florida 33342.

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Compliance with Section 16(a) of the Securities Exchange Act of 1934

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our directors and executive officers, and persons who own more than 10 percent of our common stock, to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of our common stock. Officers, directors and greater than 10 percent shareholders are required by the rules and regulations of the Securities and Exchange Commission to furnish us with copies of all Section 16(a) forms they file.

To our knowledge, based solely on review of the copies of these reports furnished to us and representations that no other reports were required, during the fiscal year ended September 30, 2004, all Section 16(a) filing requirements applicable to our officers, directors and greater than 10 percent beneficial owners were complied with, except for one report on Form 4 that was not filed on a timely basis by our Chairman, Michael D. Herman, in connection with his acquisition of shares of our common stock in exchange for his shares of stock of Percipia, Inc.

Table of Contents**EXECUTIVE COMPENSATION*****Summary Compensation Table***

The following table sets forth compensation awarded to, earned by or paid to: (i) our President and Chief Executive Officer; and (ii) each of our other named executive officers who earned \$100,000 or more during Fiscal 2004, 2003 and 2002 (the Named Executive Officers).

Name and Principal Position	Fiscal Year	Annual Compensation			Long Term Compensation			All Other Compensation
		Salary	Bonus	Other Annual Compensation	Awards Restricted Stock	Options/ SARs	Payouts LTIP Payments	
James E. Laurent President,	2004	\$ 137,500	None	None	None	None	None	None
	2003	\$ 125,000	None	None	None	None	None	None

A summary of activity for the Company's RSUs and PRSUs for the three months ended March 30, 2014 and information regarding RSUs and PRSUs outstanding and expected to vest as of March 30, 2014 is as follows:

	RSUs & PRSUs Outstanding	
	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at December 29, 2013	225	\$ 3.17
Granted	275	4.79
Vested	(242)) 4.82
Forfeited	(1)) —
Nonvested at March 30, 2014	257	\$ 3.35

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (Continued)

Employee Stock Purchase Plan

The weighted average estimated fair value, as defined by the amended authoritative guidance, of rights issued pursuant to the Company's 2009 ESPP during the first quarter of 2014 and 2013 was \$0.85 and \$0.55 per right, respectively.

As of March 30, 2014, 1.2 million shares remained available for issuance under the 2009 ESPP. For the first quarter of 2014, the Company recorded compensation expense related to the 2009 ESPP of \$60,000.

The fair value of rights issued pursuant to the Company's 2009 ESPP was estimated on the commencement date of each offering period using the following weighted average assumptions:

	Three Months Ended			
	March 30, 2014	March 31, 2013		
Expected term (months)	5.97	5.97		
Risk-free interest rate	0.09	% 0.14	%	%
Volatility	39.62	% 50.28	%	%
Dividend yield	—	—		

As of March 30, 2014, the unrecognized stock-based compensation expense relating to the Company's 2009 ESPP was \$59,000 and is expected to be recognized over a weighted average period of approximately 1.5 months.

Note 10 — Income Taxes

In the first quarter of 2014 and 2013, the Company recorded net income tax expense of \$20,000 and \$57,000, respectively, resulting primarily from its foreign operations which are cost-plus entities.

Based on the available objective evidence, management believes it is more likely than not that the Company's net deferred tax assets will not be fully realizable. Accordingly, with the exception of its foreign subsidiaries, the Company has provided a full valuation allowance against the associated deferred tax assets. The Company will continue to assess the realizability of the deferred tax assets in future periods.

The Company had approximately \$78,000 and \$79,000 of unrecognized tax benefits at March 30, 2014 and December 29, 2013, respectively, which, if recognized, would affect the Company's effective tax rate. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. For the three month period ended March 30, 2014, the company accrued \$2,000 of interest and penalties. As of March 30, 2014, the Company had approximately \$41,000 of accrued interest and penalties related to uncertain tax positions.

Included in the balance of unrecognized tax benefits at March 30, 2014 is \$36,000 related to tax positions, interest, and penalties for which it is reasonably possible that the statute of limitations will expire in various jurisdictions within the next twelve months.

As of March 30, 2014, the liability for uncertain tax positions including accrued interest and penalties was approximately \$120,000. All of which if recognized, would affect the Company's effective tax rate.

The Company is no longer subject to U.S. federal, state and non-U.S. income tax audits by taxing authorities for fiscal years through 1997.

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (Continued)

Note 11 — Information Concerning Product Lines, Geographic Information and Revenue Concentration

The Company identifies its business segment based on business activities, management responsibility and geographic location. For all periods presented, the Company operated in a single reportable business segment.

The following is a breakdown of revenue by product line (in thousands):

	Three Months Ended	
	March 30, 2014	March 31, 2013
Revenue by product line ⁽¹⁾ :		
New products	\$8,916	\$941
Mature products	2,248	2,076
Total revenue	\$11,164	\$3,017

(1) For all periods presented: New products include ArcticLink®, ArcticLink II, ArcticLink III, Eclipse™ II, PolarPro®, PolarPro II, and QuickPCI II. Mature products include Eclipse, EclipsePlus, pASIC® 1, pASIC 2, pASIC 3, QuickFC, QuickMIPS, QuickPCI, QuickRAM, and V3, as well as royalty revenue, programming hardware and software.

The following is a breakdown of revenue by shipment destination (in thousands):

	Three Months Ended	
	March 30, 2014	March 31, 2013
Revenue by geography:		
South Korea	\$7,799	\$31
United States	1,064	941
Japan	682	602
China	383	131
Malaysia	459	685
Europe	736	450
Rest of North America	36	177
Rest of Asia Pacific	5	—
Total revenue	\$11,164	\$3,017

The following distributors and customers accounted for 10% or more of the Company's revenue for the periods presented:

	Three Months Ended		
	March 30, 2014	March 31, 2013	
Distributor "A"	*	40	%
Distributor "C"	*	18	%
Customer "B"	*	24	%

Customer "F"	*	11	%
Customer "G"	70	% *	

*Represents less than 10% of revenue for the period presented.

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QUICKLOGIC CORPORATION

NOTES TO CONDENSED UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (Continued)

The following distributors and customers accounted for 10% or more of the Company's accounts receivable as of the dates presented:

	March 30, 2014	December 29, 2013		
Distributor "A"	17	% 20		%
Customer "G"	77	% 71		%

*Represents less than 10% of accounts receivable as of the date presented.

As of March 30, 2014, less than 10% of the Company's long-lived assets, including property and equipment and other assets, were located outside the United States.

Note 12 — Commitments and Contingencies

The Company's manufacturing suppliers require us to forecast wafer starts several months in advance. The Company is committed to take delivery of and pay for a portion of forecasted wafer volume. As of March 30, 2014 and December 29, 2013, the Company had \$5.8 million and \$10.8 million, respectively, of outstanding commitments for the purchase of wafer and finished goods inventory.

The Company has obligations with certain suppliers for the purchase of other goods and services entered into in the ordinary course of business. As of March 30, 2014, total outstanding purchase obligations were \$830,000, which are primarily due within the next twelve months.

The Company leases its primary facility under a non-cancelable operating lease that expires at the end of 2018. In addition, the Company rents development facilities in India as well as sales offices in Europe and Asia. Total rent expense, net of sublease income, for the first quarters of 2014 and 2013 was approximately \$231,000 and \$233,000, respectively.

As of March 30, 2014, future minimum lease commitments under the Company's operating leases, excluding property taxes and insurance are as follows:

Fiscal Years	Operating Leases (in thousands)
2014 (Remaining 9 months)	\$679
2015	868
2016	814
2017	776
2018	799
	\$3,936

Note 13 — Litigation

From time to time, the Company may become involved in legal actions arising in the ordinary course of business including, but not limited to, intellectual property infringement and collection matters. Absolute assurance cannot be given that any such third party assertions will be resolved: without costly litigation; in a manner that is not adverse to the Company's financial position, results of operations or cash flows; or without requiring royalty or other payments which may adversely impact gross profit.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations, as well as information contained in "Risk Factors" in Part II, Item 1A and elsewhere in this Quarterly Report on Form 10-Q, contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We intend that these forward-looking statements be subject to the safe harbor created by those provisions. Forward-looking statements are generally written in the future tense and/or are preceded by words such as "will," "may," "should," "forecast," "could," "expect," "suggest," "believe," "anticipate," "intend," "plan," or other similar words. Forward-looking statements include statements regarding our strategies as well as (1) our revenue levels, including the commercial success of our Customer Specific Standard Products, or CSSPs, and new products, (2) the conversion of our design opportunities into revenue, (3) our liquidity, (4) our research and development efforts, (5) our gross profit and factors that affect gross profit, (6) our level of operating expenses, (7) our partners and suppliers and (8) industry trends. The following discussion should be read in conjunction with the attached condensed unaudited consolidated financial statements and notes thereto, and with our condensed audited consolidated financial statements and notes thereto for the fiscal year ended December 29, 2013, found in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on March 6, 2014. Although we believe that the assumptions underlying the forward-looking statements contained in this Quarterly Report are reasonable, any of the assumptions could be inaccurate, and therefore there can be no assurance that such statements will be accurate. The risks, uncertainties and assumptions referred to above that could cause our results to differ materially from the results expressed or implied by such forward-looking statements include, but are not limited to, those discussed under the heading "Risk Factors" in Part II, Item 1A hereto and the risks, uncertainties and assumptions discussed from time to time in our other public filings and public announcements. All forward-looking statements included in this document are based on information available to us as of the date hereof. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that the results or conditions described in such statements or our objectives and plans will be achieved. Furthermore, past performance in operations and share price is not necessarily indicative of future performance. We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

We develop and market low-power customizable semiconductor solutions that enable customers to add new differentiated features, extend battery life and improve the visual experience with their mobile, consumer and enterprise products. Our targeted mobile market segment includes Smartphones, Tablets, Wearables, and Mobile Enterprise. Our solutions typically fall into one of three product categories: Display & Visual Enhancement, Smart Connectivity and Ultra-Low Power Sensor Hubs. We are a fabless semiconductor company that designs Customer Specific Standard Products, or CSSPs, which are complete, customer-specific solutions that includes one or more of the following: a combination of silicon solution platforms; Proven System Blocks, or PSBs; customer-specific logic; algorithms; software drivers; and firmware. Our main platform families, ArcticLink and PolarPro, are standard silicon platforms. Recent examples of PSBs that have been developed and that are available to customers include driving one or more LEDs, Barcode transmission via InfraRed (IR) Light Emitting Diode (LED) and TV remote control via LED. The variety of PSBs offered by us allows system designers to combine multiple discrete chips onto a single CSSP, simplifying design and board layout, lowering BOM cost, and accelerating time-to-market. The programmable logic of the platforms is used for adding differentiated features and provides flexibility to address hardware-based product requirements quickly.

Utilizing a focused customer engagement model, we market CSSPs to Original Equipment Manufacturers, or OEMs, and Original Design Manufacturers, or ODMs, that offer differentiated mobile products, and to processor vendors

wishing to expand their served available market through the deployment of reference designs to their customers. Our solutions enable OEMs and ODMs to add new features, extend battery life and improve the visual experience of their handheld mobile devices. In addition to working directly with our customers, we partner with other companies with expertise in certain technologies to develop additional intellectual property, reference platforms and system software to provide application solutions. When we bring solutions to market with a partner company, we typically launch the solution as a Catalog CSSP. This enables us to sell the product as a 'catalog' device to any customer. In this manner, we are able to broaden the served available market for our CSSP solutions and leverage our R&D across multiple end customers.

We also work with mobile processor manufacturers in the development of reference designs or “Catalog” CSSPs. Through reference designs that incorporate our CSSPs, we believe mobile processor manufacturers can expand the served

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations — (Continued)

available market for their processors. Furthermore, should a CSSP development for a processor manufacturer be applicable to a set of common OEMs or ODMs, we can amortize our R&D investment over that set of OEMs/ODMs. We call this type of solution a Catalog CSSP. The most recent example Catalog CSSP, announced during early 2014, was an Android KitKat compatible, context aware, ultra-low power sensor hub. We are placing a greater emphasis on developing and marketing Catalog CSSPs in the future.

In order to grow our revenue from its current level, we depend upon increased revenue from our new products including existing new product platforms and platforms currently in development. We expect our business growth to be driven by CSSPs and our CSSP revenue growth needs to be strong enough to enable us to sustain profitability while we continue to invest in the development, sales and marketing of our new solution platforms, PSBs, algorithms, firmware, and CSSPs. The gross margin associated with our CSSPs is generally lower than the gross margin of our FPGA products, due primarily to the price sensitive nature of the higher volume mobile consumer opportunities that we are pursuing with CSSPs.

During the first quarter of 2014, we generated total revenue of \$11.2 million which represents an increase of 26% over the prior quarter and an increase of 270% from the first quarter of 2013. Our new product revenue increased to \$8.9 million, up 27% sequentially and up 848% year over year. The increase in new product revenue was primarily due to shipments of our ArcticLink III solution platform to Samsung. Revenue generated from Samsung accounted for 88% of our new product revenue and 70% of our total revenue. During the quarter, new products were shipped into the Tablet, Smartphone and the Mobile Enterprise markets. Our mature product revenue was \$2.2 million, up 24% sequentially and up 8% year over year. We devote substantially all of our development, sales and marketing efforts on our new solution platforms, PSBs and CSSPs. We expect our revenue from mature products to continue to decline over time. Overall, we reported a net loss of \$2.1 million for the first quarter of 2014 compared to a net loss of \$3.6 million for the first quarter of 2013.

Critical Accounting Estimates

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our consolidated financial statements. The SEC has defined critical accounting policies as those that are most important to the portrayal of our financial condition and results of operations and require us to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, our critical policies include revenue recognition, valuation of inventories including identification of excess quantities and product obsolescence, valuation of investments, valuation of long-lived assets, measurement of stock-based compensation and estimating accrued liabilities. We believe that we apply judgments and estimates in a consistent manner and that this consistent application results in consolidated financial statements and accompanying notes that fairly represent all periods presented. However, any factual errors or errors in these judgments and estimates may have a material impact on our financial statements. For a discussion of critical accounting policies and estimates, please see Item 7 in our Annual Report on Form 10-K for the fiscal year ended December 29, 2013, filed with the SEC on March 6, 2014.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations — (Continued)

Results of Operations

The following table sets forth the percentage of revenue for certain items in our statements of operations for the periods indicated:

	Three Months Ended			
	March 30, 2014		March 31, 2013	
Revenue	100	%	100	%
Cost of revenue	64	%	66	%
Gross profit	36	%	34	%
Operating expenses:				
Research and development	24	%	67	%
Selling, general and administrative	31	%	84	%
Loss from operations	(19))%	(117))%
Interest expense	—	%	—	%
Interest income and other expense, net	—	%	—	%
Loss before income taxes	(19))%	(117))%
Provision for income taxes	—	%	2	%
Net loss	(19))%	(119))%

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations — (Continued)

Three Months Ended March 30, 2014 and March 31, 2013

Revenue

The table below sets forth the changes in revenue for the three months ended March 30, 2014, as compared to the three months ended March 31, 2013 (in thousands, except percentage data):

	Three Months Ended March 30, 2014		March 31, 2013		Change		Percentage	
	Amount	% of Total Revenues	Amount	% of Total Revenues	Amount			
Revenue by product line ⁽¹⁾ :								
New products	\$8,916	80 %	\$941	31 %	\$7,975		848	%
Mature products	2,248	20 %	2,076	69 %	172		8	%
Total revenue	\$11,164	100 %	\$3,017	100 %	\$8,147		270	%

(1) For all periods presented: New products include ArcticLink®, ArcticLink II, ArcticLink III, Eclipse™ II, PolarPro®, PolarPro II, and QuickPCI II. Mature products include Eclipse, EclipsePlus, pASIC® 1, pASIC 2, pASIC 3, QuickFC, QuickMIPS, QuickPCI, QuickRAM, and V3, as well as royalty revenue, programming hardware and software.

The increase in new product revenue was primarily due to shipments to Samsung which has designed our ArcticLink III VX into a new tablet platform. Revenue generated from Samsung accounted for 88% of the new product revenue and 70% of total revenue in the first quarter of 2014. The increase in mature product revenue is due primarily to increased orders from our customers in the aerospace, test and instrumentation sectors.

We continue to seek to expand our revenue through the pursuit of high volume sales opportunities in our target market segments and the sale of CSSPs incorporating our PSBs. Our industry is characterized by intense price competition and by lower margins as order volumes increase. Due to the concentration of our new product revenue in Samsung combined with the cyclical nature of the mobile market, we may face the prospect of significant fluctuation in new product revenue. While winning large-volume sales opportunities will increase our revenue, due to the pricing negotiation leverage of large companies, these opportunities may decrease our gross profit as a percentage of revenue. In addition, these large companies provide long-term purchase forecasts which are not binding and may not result in revenue.

Gross Profit

The table below sets forth the changes in gross profit for the three months ended March 30, 2014 as compared to the three months ended March 31, 2013 (in thousands, except percentage data):

	Three Months Ended March 30, 2014		March 31, 2013		Change		Percentage	
	Amount	% of Total Revenues	Amount	% of Total Revenues	Amount			
Revenue	\$11,164	100 %	\$3,017	100 %	\$8,147		270	%
Cost of revenue	7,106	64 %	1,986	66 %	5,120		258	%

Gross Profit	\$4,058	36	%	\$1,031	34	%	\$3,027	294	%
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The \$3.0 million increase in gross profit in the first quarter of 2014 as compared to the first quarter of 2013 was mainly due to the increase in revenue and favorable purchase price adjustments, partially offset by the increase in inventory reserve of \$64,000 and the increase in royalties of \$268,000 in the first quarter of 2014. The 2% increase in gross margin was primarily due to improved manufacturing efficiency resulting from higher revenue.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations — (Continued)

Our semiconductor products have historically had long product life cycles and obsolescence has not been a significant factor in the valuation of inventories. However, as we continue to pursue opportunities in the mobile market and continue to develop new CSSPs and products, we believe our product life cycle will be shorter and increase the potential for obsolescence. We also regularly review the cost of inventories and purchase commitments against estimated market value and record a lower of cost or market reserve for inventories that have a cost in excess of estimated market value. This could have a material impact on our gross margin and inventory balances based on additional write-downs to net realizable value or a benefit from inventories previously written down. In addition, our standard manufacturing lead times are longer than the binding forecasts we receive from larger companies. A significant decrease in the long term forecast could materially impact our inventory balance.

Operating Expenses

The table below sets forth the changes in operating expenses for the three months ended March 30, 2014, as compared to the three months ended March 31, 2013 (in thousands, except percentage data):

	Three Months Ended		March 31, 2013	Change	Amount	Percentage
	March 30, 2014					
	Amount	% of Total Revenues	Amount	% of Total Revenues		
R&D expense	\$2,641	24 %	\$2,008	67 %	\$633	32 %
SG&A expense	3,465	31 %	2,530	84 %	935	37 %
Restructuring costs	—	— %	7	— %	(7)	(100)%
Total operating expenses	\$6,106	55 %	\$4,545	151 %	\$1,561	34 %

Research and Development

Our research and development, or R&D, expenses consist primarily of personnel, overhead and other costs associated with engineering process improvements, programmable logic design, CSSP design and software development. The \$633,000 increase in R&D expenses in the first quarter of 2014, as compared to the first quarter of 2013, was attributable primarily to a \$315,000 increase in stock-based compensation expenses related to RSU bonuses and a \$246,000 increase in compensation expenses due to an increase in headcount.

Selling, General and Administrative Expense

Our selling, general and administrative, or SG&A, expenses consist primarily of personnel and related overhead costs for sales, marketing, finance, administration, human resources and general management. The \$935,000 increase in SG&A expenses in the first quarter of 2014, as compared to the first quarter of 2013, was primarily due to a \$521,000 increase in stock-based compensation expenses related to RSU bonuses; a \$454,000 increase in outside services related to sales commissions; and a \$86,000 increase in compensation expenses. These increases were offset by a decrease of \$44,000 in travel and entertainment expenses.

Interest Expense and Interest Income and Other Expense, Net

The table below sets forth the changes in interest expense and interest income and other, net, for the three months ended March 30, 2014 as compared to the three months ended March 31, 2013 (in thousands, except percentage data):

Three Months Ended	Change
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	March 30, 2014		March 31, 2013		Amount		Percentage	
Interest expense	\$(16)	\$(9)	\$(7)	78	%
Interest income and other expense, net	(26)	(4)	(22)	550	%
	\$(42)	\$(13)	\$(29)	223	%

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations — (Continued)

The increase in interest expense was due primarily to the increase in our average debt obligation to \$1.3 million in the first quarter of 2014 from \$400,000 in the first quarter of 2013. The change in interest income and other expense, net, was due primarily to foreign exchange fluctuations in the first quarter of 2014 as compared to the first quarter of 2013.

We conduct a portion of our research and development activities in Canada and India and we have sales and marketing activities in various countries outside of the United States. Most of these international expenses are incurred in local currency. Foreign currency transaction gains and losses are included in interest and other income (expense), net, as they occur. We do not use derivative financial instruments to hedge our exposure to fluctuations in foreign currency and, therefore, our results of operations are, and will continue to be, susceptible to fluctuations in foreign exchange gains or losses.

Provision for Income Taxes

The table below sets forth the changes in provision for income taxes for the three months ended March 30, 2014 as compared to the three months ended March 31, 2013 (in thousands, except percentage data):

	Three Months Ended		Change	
	March 30, 2014	March 31, 2013	Amount	Percentage
Provision for income taxes	\$20	\$57	\$(37)	(65)%

The income tax provision for the first quarters of 2014 and 2013 was primarily from our foreign operations which are cost-plus entities. As of the end of the first quarter of 2014, our ability to utilize our income tax loss carryforwards in future periods is uncertain and, accordingly, we recorded a full valuation allowance against the related U.S. tax provision. We will continue to assess the realizability of deferred tax assets in future periods.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations — (Continued)

Liquidity and Capital Resources

We have financed our operating losses and capital investments through sales of common stock, private equity investments, capital and operating leases, a revolving line of credit and cash flows from operations. As of March 30, 2014, our principal sources of liquidity consisted of our cash and cash equivalents of \$37.1 million and available credit under our revolving line of credit with Silicon Valley Bank of \$5.0 million which expires on June 27, 2014. The borrowing under the Company's line of credit is subject to maintaining a tangible net worth of at least \$15.0 million, unrestricted cash or cash equivalent balance of at least \$8.0 million and a quick ratio of 2-to-1. Upon each advance, the Company can elect one of two interest rates: the prime rate plus the prime rate margin, or the LIBOR plus the LIBOR rate margin. We were in compliance with all loan covenants as of the end of the current reporting period. As of March 30, 2014, the Company had \$1.0 million of revolving debt outstanding with an interest rate of 3.73%.

We currently use cash to fund capital expenditures and operating losses. Based on past performance and current expectations, we believe that our existing cash and cash equivalents, together with available financial resources from the revolving line of credit facility will be sufficient to fund our operations and capital expenditures, and provide adequate working capital for the next twelve months.

Over the longer term, based on our current expectations regarding revenue growth and margin improvement, we believe that our existing cash and cash equivalents, together with financial resources generated from our revolving line of credit with Silicon Valley Bank and our ability to sell additional shares to capital markets, will be sufficient to satisfy our operations and capital expenditures.

Most of our cash and cash equivalents were invested in a U.S. Treasury money market fund rated AAAm/Aaa. Our interest-bearing debt consisted of \$309,000 outstanding under capital leases (see Note 5 of the Condensed Unaudited Consolidated Financial Statements).

Cash balances held at our foreign subsidiaries were approximately \$917,000 and \$882,000 at March 30, 2014 and December 29, 2013, respectively. Earnings from our foreign subsidiaries are currently deemed to be indefinitely reinvested. We do not expect such reinvestment to affect our liquidity and capital resources, and we continually evaluate our liquidity needs and ability to meet global cash requirements as a part of our overall capital deployment strategy. Factors which affect our global capital deployment strategy include anticipated cash flows, the ability to repatriate cash in a tax efficient manner, funding requirements for operations and investment activities, acquisitions and divestitures and capital market conditions.

Net cash from operating activities

Net cash used for operating activities was \$2.8 million in the first three months of 2014. The cash used for operating activities resulted primarily from the net loss of \$2.1 million and cash used for operating assets and liabilities of \$1.9 million offset by \$1.2 million of non-cash charges. These non-cash charges consisted primarily of stock-based compensation of \$732,000, depreciation and amortization of \$362,000, and a write-down of inventory of \$64,000. The cash used for operating assets and liabilities was mostly due to an increase in inventories in anticipation of future revenues and a reduction in accounts payable due to timing of payments.

Net cash used for operating activities was \$2.8 million in the first three months of 2013. The cash used for operating activities resulted primarily from the net loss of \$3.6 million and cash used for operating assets and liabilities of \$388,000 offset by \$1.1 million of non-cash charges. These non-cash charges consisted primarily of stock-based compensation of \$452,000, depreciation and amortization of \$317,000, and a write-down of inventory of \$343,000.

The cash used for operating assets and liabilities was mostly due to a reduction in accounts payable due to timing of payments and an increase in accounts receivable due to the timing of quarter end revenues.

Net cash from investing activities

Net cash used by investing activities for the first three months of 2014 was \$10,000, which was primarily from cash used to acquire equipment and software used for the production and development of new products. Capital expenditures, which are largely driven by the development of new products and manufacturing levels, are projected to be approximately \$2.1 million during the remainder of fiscal year 2014.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations — (Continued)

Net cash used by investing activities for the first three months of 2013 was \$62,000, which was primarily used to acquire equipment and software used for the production and development of new products.

Net cash from financing activities

Net cash provided by financing activities was \$2.6 million for the first three months of 2014, primarily derived from proceeds related to the issuance of common shares to employees under our equity plans.

Net cash used by financing activities was \$28,000 for the first three months of 2013, derived from \$35,000 of scheduled payments under the terms of our capital lease obligations, offset by \$7,000 in proceeds related to the issuance of common shares to employees under our equity plans.

We require substantial cash to fund our business. However, we believe that our existing cash and cash equivalents, together with available financial resources from the revolving line of credit facility and our access to capital markets, will be sufficient to satisfy our operations and capital expenditures over the next twelve months. After the next twelve months, our cash requirements will depend on many factors including our level of revenue and gross profit, the market acceptance of our existing and new products, the levels at which we maintain inventories and accounts receivable, costs of securing access to adequate manufacturing capacity, new product development efforts, capital expenditures and the level of our operating expenses.

Contractual Obligations and Commercial Commitments

The following table summarizes our contractual obligations and commercial commitments as of March 30, 2014 and the effect such obligations and commitments are expected to have on our liquidity and cash flows in future fiscal periods (in thousands):

	Payments Due by Period			
	Total	Less than 1 Year	1-3 Years	More than 3 Years
Contractual obligations:				
Operating leases	\$3,936	\$900	\$1,655	\$1,381
Wafer purchases ⁽¹⁾	5,808	5,808	—	—
Other purchase commitments	830	830	—	—
Total contractual cash obligations	10,574	7,538	1,655	1,381
Other commercial commitments ⁽²⁾ :				
Revolving line of credit	1,000	1,000	—	—
Capital lease obligations ⁽³⁾	309	209	100	—
Total commercial commitments	1,309	1,209	100	—
Total contractual obligations and commercial commitments ⁽⁴⁾	\$11,883	\$8,747	\$1,755	\$1,381

Certain of our wafer manufacturers require us to forecast wafer starts several months in advance. We are

⁽¹⁾ committed to take delivery of and pay for a portion of forecast wafer volume. Wafer and finished goods purchase commitments of \$5.8 million include firm purchase commitments as of March 30, 2014.

⁽²⁾ Other commercial commitments are included as liabilities on our balance sheet as of March 30, 2014.

⁽³⁾ For a detailed explanation, see Note 5 of the Condensed Unaudited Consolidated Financial Statements.

- (4) Does not include unrecognized tax benefits of \$78,000 as of March 30, 2014. See Note 10 of the Condensed Unaudited Consolidated Financial Statements.

Concentration of Suppliers

We depend on a limited number of contract manufacturers, subcontractors, and suppliers for wafer fabrication, assembly, programming and testing of our devices, and for the supply of programming equipment. These services are typically provided by one supplier for each of our devices. We generally purchase these single or limited source services through standard purchase orders. Because we rely on independent subcontractors to perform these services, we cannot directly control product delivery schedules, costs or quality levels. Our future success also depends on the financial viability of our independent

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations — (Continued)

subcontractors. These subcontract manufacturers produce products for other companies and we must place orders up to several months in advance of expected delivery. As a result, we have only a limited ability to react to fluctuations in demand for our products, which could cause us to have an excess or a shortage of inventories of a particular product, and our ability to respond to changes in demand is limited by these suppliers' ability to provide products with the quantity, quality, cost and timeliness that we require. The decision not to provide these services to us or the inability to supply these services to us, such as in the case of a natural or financial disaster, would have a significant impact on our business. Increased demand from other companies could result in these subcontract manufacturers allocating available capacity to customers that are larger or have long-term supply contracts in place and we may be unable to obtain adequate foundry and other capacity at acceptable prices, or we may experience delays or interruption in supply. Additionally, volatility of economic, market, social and political conditions in countries where these suppliers operate may be unpredictable and could result in a reduction in product revenue or increase our cost of revenue and could adversely affect our business, financial condition and results of operations.

Off-Balance Sheet Arrangements

We do not maintain any off-balance sheet partnerships, arrangements or other relationships with unconsolidated entities or others, often referred to as structured finance or special purpose entities, which are established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations — (Continued)

Recently Issued Accounting Pronouncements

See Note 2 of the Condensed Unaudited Consolidated Financial Statements for a description of recent accounting pronouncements, including the respective dates of adoption and expected effects on results of operations and financial condition.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio and variable rate debt. We do not use derivative financial instruments to manage our interest rate risk. We are adverse to principal loss and ensure the safety and preservation of invested funds by limiting default, market risk and reinvestment risk. Our investment portfolio is generally comprised of investments that meet high credit quality standards and have active secondary and resale markets. Since these securities are subject to interest rate risk, they could decline in value if interest rates fluctuate or if the liquidity of the investment portfolio were to change. Due to the short duration and conservative nature of our investment portfolio, we do not anticipate any material loss with respect to our investment portfolio. A 10% move in interest rates as of the end of the first quarter of 2014 would have an immaterial effect on our financial position, results of operations and cash flows.

Foreign Currency Exchange Rate Risk

All of our sales and costs of manufacturing are transacted in U.S. dollars. We conduct a portion of our research and development activities in Canada and India and have sales and marketing offices in several locations outside of the United States. We use the U.S. dollar as our functional currency. Most of the costs incurred at these international locations are in local currency. If these local currencies strengthen against the U.S. dollar, our payroll and other local expenses will be higher than we currently anticipate. Since our sales are transacted in U.S. dollars, this negative impact on expenses would not be offset by any positive effect on revenue. Operating expenses denominated in foreign currencies were approximately 21% and 20% of total operating expenses for the first three months of 2014 and 2013, respectively. A currency exchange rate fluctuation of 10% would have caused our operating expenses to change by approximately \$126,000 in the first three months of 2014.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on management's evaluation as of March 30, 2014, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective at the reasonable assurance level to ensure that the information required to be disclosed by us in this Quarterly Report on Form 10-Q was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all error and fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 1. Legal Proceedings

See Note 13 of the Condensed Unaudited Consolidated Financial Statements for a description of legal proceedings.

Item 1A. Risk Factors

Our 2013 Annual Report on Form 10-K for the year ended December 29, 2013, filed with the SEC on March 6, 2014, includes a detailed discussion of our risk factors at Part I, Item 1A, Risk Factors, which discussion is hereby incorporated by reference into this Part II, Item 1A. The information presented below updates and supplements, and should be read in conjunction with the risk factors and information disclosed in that Form 10-K and in conjunction with any subsequent updates disclosed in our quarterly filings on Form 10-Q.

The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks not currently known to us or that we currently deem to be immaterial may also adversely affect our business and results from operations.

Risk Factors

Currently we depend on Samsung for a significant portion of our revenue and the loss of or reduction in orders from Samsung could adversely affect our revenue and harm our business, financial condition, operating results and cash flows.

During our first quarter ended March 30, 2014, Samsung accounted for 70% of our total revenue. In the future, Samsung may purchase fewer of our products, modify the terms on which they purchase our products or decide not to continue to purchase our products. Samsung is not required to continue to purchase our products and if we fail to continue to make design wins with Samsung, or properly time our inventory purchases, which require a commitment by us with suppliers several months prior to forecast shipments to Samsung, our future revenue and profitability may be adversely affected.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 6. Exhibits

a. Exhibits

The following Exhibits are filed with this report:

Exhibit Number	Description
31.1	CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	CEO and CFO Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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Signatures

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

Date: May 7, 2014

QUICKLOGIC
CORPORATION

/s/ Ralph S. Marimon
Ralph S. Marimon
Vice President, Finance and
Chief Financial Officer
(as Principal Accounting and
Financial Officer and on behalf
of the Registrant)

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