

CECO ENVIRONMENTAL CORP  
Form 10-Q  
November 15, 2010  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, DC 20549

**FORM 10-Q**

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2010

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 000-07099

**CECO ENVIRONMENTAL CORP.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)  
**3120 Forrer Street, Cincinnati, Ohio 45209**  
(Address of principal executive offices) (Zip Code)  
**513-458-2600**  
(Registrant's telephone number, including area code)

**13-2566064**  
(I.R.S. Employer  
Identification No.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232, 405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act). See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (check one):

Large Accelerated Filer  Accelerated Filer   
Non-Accelerated Filer  Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of latest practical date.

Class: Common, par value \$.01 per share outstanding at November 3, 2010 14,318,739

**Table of Contents**

**CECO ENVIRONMENTAL CORP.**  
**QUARTERLY REPORT UNDER SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**  
**SEPTEMBER 30, 2010**  
**TABLE OF CONTENTS**

**Part I - Financial Information:**

Item 1.	<u>Condensed Consolidated balance sheets as of September 30, 2010 and December 31, 2009</u>	2
	<u>Condensed Consolidated statements of operations for the three-month and nine-month periods ended September 30, 2010 and 2009</u>	3
	<u>Condensed Consolidated statements of cash flows for the nine-month periods ended September 30, 2010 and 2009</u>	4
	<u>Notes to consolidated financial statements</u>	5
Item 2.	<u>Management's discussion and analysis of financial condition and results of operations</u>	14
Item 4T.	<u>Controls and Procedures</u>	21

**Part II - Other Information**

Item 6.	<u>Exhibits</u>	22
	<u>Signature</u>	23

**Table of Contents****CECO ENVIRONMENTAL CORP.****PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****CONDENSED CONSOLIDATED BALANCE SHEETS**

Dollars in thousands, except per share data

	September 30, 2010 (unaudited)	December 31, 2009
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 4,185	\$ 1,393
Accounts receivable, net	20,565	23,751
Costs and estimated earnings in excess of billings on uncompleted contracts (Note 4)	9,587	10,681
Inventories, net (Note 3)	4,698	4,877
Prepaid expenses and other current assets	3,070	2,969
Current assets of discontinued operations (Note 15)	281	1,877
<b>Total current assets</b>	<b>42,386</b>	<b>45,548</b>
Property and equipment, net	5,955	11,362
Property and equipment held for sale, net (Note 16)	4,471	
Goodwill, net (Note 5)	14,637	14,591
Intangibles - finite life, net (Note 5)	1,095	1,470
Intangibles - indefinite life (Note 5)	3,215	3,209
Deferred income tax asset, net	348	348
Deferred charges and other assets	952	930
Non-current assets of discontinued operations (Note 15)		57
	<b>\$ 73,059</b>	<b>\$ 77,515</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of debt (Note 8)	\$ 1,470	\$ 836
Accounts payable and accrued expenses	14,799	18,622
Billings in excess of costs and estimated earnings on uncompleted contracts (Note 4)	7,265	10,373
Accrued income taxes	314	
Current liabilities of discontinued operations (Note 15)	7	648
<b>Total current liabilities</b>	<b>23,855</b>	<b>30,479</b>
Other liabilities	2,779	2,605
Debt, less current portion (Note 8)	1,629	1,871
Convertible subordinated notes (including related parties notes of \$3,800) (Note 8)	10,800	10,800
<b>Total liabilities</b>	<b>39,063</b>	<b>45,755</b>

## Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

<b>Shareholders' equity:</b>		
Common stock, \$0.01 par value; 100,000,000 shares authorized, 14,456,659 and 14,427,251 shares issued in 2010 and 2009, respectively	144	144
Capital in excess of par value	43,142	42,341
Accumulated deficit	(6,986)	(8,348)
Accumulated other comprehensive loss	(1,948)	(2,021)
	34,352	32,116
Less treasury stock, at cost, 137,920 shares in 2010 and 2009	(356)	(356)
<b>Total shareholders' equity</b>	<b>33,996</b>	<b>31,760</b>
	<b>\$ 73,059</b>	<b>\$ 77,515</b>

The notes to condensed consolidated financial statements are an integral part of the above statements.

**Table of Contents****CECO ENVIRONMENTAL CORP.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited)**

Dollars in thousands, except per share data

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2010	2009	2010	2009
Net sales	\$ 33,860	\$ 31,964	\$ 103,657	\$ 102,396
Cost of sales	26,132	25,090	79,513	79,299
Gross profit	7,728	6,874	24,144	23,097
Selling and administrative	6,648	7,034	20,786	21,793
Amortization	118	139	378	618
Gain on sale of operating equipment	(608)		(608)	
Income (loss) from continuing operations	1,570	(299)	3,588	686
Other income (expense), net	(68)	(374)	(121)	(546)
Interest expense (including related parties interest of \$58 and \$122, and \$171 and \$309, respectively) (Note 8)	(341)	(326)	(942)	(1,035)
Income (loss) from continuing operations before income taxes	1,161	(999)	2,525	(895)
Income tax expense (benefit)	488	(350)	1,008	(313)
Income (loss) from continuing operations	673	(649)	1,517	(582)
Net income (loss) from discontinued operations, net of tax (Note 15)	10	(29)	(155)	(366)
Net income (loss)	\$ 683	\$ (678)	\$ 1,362	\$ (948)
Earnings (loss) per share (Note 7):				
Basic net income (loss) from continuing operations	\$ .05	\$ (.05)	\$ .11	\$ (.04)
Basic net income (loss) from discontinued operations	.00	(.00)	(.01)	(.03)
Basic net income (loss)	\$ .05	\$ (.05)	\$ .10	\$ (.07)
Diluted net income (loss) from continuing operations	\$ .05	\$ (.05)	\$ .10	\$ (.04)
Diluted net income (loss) from discontinued operations	.00	(.00)	(.01)	(.03)
Diluted net income (loss)	\$ .05	\$ (.05)	\$ .09	\$ (.07)
Weighted average number of common shares outstanding:				
Basic	14,320,188	14,241,594	14,304,554	14,214,065

Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

Diluted	17,128,215	14,241,594	14,396,965	14,214,065
---------	------------	------------	------------	------------

The notes to condensed consolidated financial statements are an integral part of the above statements.

**Table of Contents****CECO ENVIRONMENTAL CORP.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**

Dollars in thousands

	<b>NINE MONTHS ENDED SEPTEMBER 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 1,362	\$ (948)
Net loss from discontinued operations	(155)	(366)
Net income (loss) from continuing operations	1,517	(582)
<b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b>		
Depreciation and amortization	1,322	1,886
Non cash interest expense included in net income (loss)	86	20
Non cash loss on remeasurement of subordinated debt		340
Gain from disposal of fixed assets	(608)	
Share based compensation expense	694	711
Employee stock purchase plan expense	96	
Bad debt expense	163	392
Inventory reserve	100	
<b>Changes in operating assets and liabilities:</b>		
Accounts receivable	3,023	16,772
Inventories	(309)	1,075
Costs and estimated earnings in excess of billings on uncompleted contracts	1,094	2,737
Prepaid expenses and other current assets	(101)	(890)
Deferred charges and other assets	239	(101)
Accounts payable and accrued expenses	(3,847)	(9,423)
Billings in excess of costs and estimated earnings on uncompleted contracts	(3,108)	(51)
Accrued income taxes	314	(2,402)
Other liabilities	193	344
Net cash provided by continuing operating activities	868	10,828
Net cash provided by discontinued operating activities	857	2,540
Net cash provided by operating activities	1,725	13,368
<b>Cash flows from investing activities:</b>		
Acquisitions of property and equipment	(400)	(997)
Proceeds from sale of equipment	1,411	
Net cash provided by (used in) investing activities	1,011	(997)
<b>Cash flows from financing activities:</b>		
Net borrowings (repayments) on revolving credit lines	690	(10,926)
Proceeds from exercise of stock options	11	
Subordinated debt borrowings		3,000



Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

Subordinated debt repayments		(3,000)
Cash paid for deferred financing costs	(347)	
Repayment of term debt	(298)	(1,750)
Net cash provided by (used in) financing activities	56	(12,676)
Net increase (decrease) in cash and cash equivalents	2,792	(305)
Cash and cash equivalents at beginning of the period	1,393	1,147
Cash and cash equivalents at end of the period	\$ 4,185	\$ 842

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid (refunded) during the period for:		
Interest	\$ 1,261	\$ 1,230
Income taxes	\$ (234)	\$ 2,407

The notes to condensed consolidated financial statements are an integral part of the above statements.

**Table of Contents**

**CECO ENVIRONMENTAL CORP.**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**1. Basis of reporting for condensed consolidated financial statements and significant accounting policies.**

The accompanying unaudited condensed consolidated financial statements of CECO Environmental Corp. and subsidiaries (the Company, we, us, or our) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, the accompanying unaudited, condensed consolidated financial statements of the Company contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the financial position as of September 30, 2010 and December 31, 2009 and the results of operations for the three-month and nine-month periods ended September 30, 2010 and 2009 and of cash flows for the nine-month periods ended September 30, 2010 and 2009. The results of operations for the three-month and nine-month periods ended September 30, 2010 are not necessarily indicative of the results to be expected for the full year. The balance sheet as of December 31, 2009 has been derived from the audited consolidated financial statements included in the Company's annual report on Form 10-K for the year ended December 31, 2009 filed with the Securities and Exchange Commission.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

During 2009, the Company discontinued the operations of its subsidiary, H.M. White, Inc. (H.M. White). In accordance with the provisions of FASB ASC Subtopic 205-20, the results of H.M. White are presented as discontinued operations for all periods in the consolidated financial statements. See Footnote 15 for additional details.

These financial statements and accompanying notes should be read in conjunction with the audited financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009 filed with the Securities and Exchange Commission.

**2. New Accounting Pronouncements**

***Recently Issued Accounting Pronouncements***

Accounting Standards Codification (ASC) 605-25 In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2009-13 for updated revenue recognition guidance under the provisions of ASC 605-25, Multiple-Element Arrangements. The previous guidance has been retained for criteria to determine when delivered items in a multiple-deliverable arrangements should be considered separate units of accounting, however the updated guidance removes the previous separation criterion that objective and reliable evidence of fair value of any undelivered items must exist for the delivered items to be considered a separate unit or separate units of accounting. This guidance is effective for fiscal years beginning on or after June 15, 2010. The Company does not expect that the adoption of this guidance will have a material effect on the Company's consolidated results of operations, financial position or cash flows.

ASC 820 In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures About Fair Value Measurements. This guidance amends Subtopic 820-10 to require new disclosures and clarify existing disclosures. This guidance requires new disclosures of amounts and reasons for significant transfers between Level 1 and Level 2 fair value measurements. Additionally, in the reconciliation for fair value measurements using significant unobservable inputs (Level 3), separate presentation of information about purchases, sales, issuances and settlements is required. The guidance clarifies that fair value measurement disclosures for each class of assets and liabilities may constitute a subset of assets and liabilities within a line item on a reporting entity's balance sheet. The guidance also clarifies disclosure requirements about inputs and valuation techniques for both recurring and nonrecurring fair value measurements (Level 2 or Level 3). The ASU also amends guidance on employers' disclosures about postretirement benefit plan assets under ASC 715 to require that disclosures be provided by classes of assets instead of by major categories of assets. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases,

## Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

sales, issuances and settlements in the roll forward of activity for Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, including interim periods within those fiscal years. The Company has not had and does not expect that the adoption of this remaining guidance will have a material effect on the Company's consolidated results of operations, financial position or cash flows.

**Table of Contents****CECO ENVIRONMENTAL CORP.****NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

ASC 815 In March 2010, the FASB issued ASU 2010-11, Scope Exception Related to Embedded Credit Derivatives to address questions that have been raised in practice about the intended breadth of the embedded credit derivative scope exception in paragraphs 815-15-15-8 through 815-15-15-9 of ASC 815, Derivatives and Hedging. The amended guidance clarifies that the scope exception applies to contracts that contain an embedded credit derivative that is only in the form of subordination of one financial instrument to another. This guidance is effective on July 1, 2010 for the Company. The adoption of this guidance did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

**3. Inventories**

<b>\$ in thousands</b>	<b>September 30, 2010</b>	<b>December 31, 2009</b>
Raw materials and subassemblies	\$ 3,438	\$ 3,322
Finished goods	1,046	1,044
Parts for resale	623	566
Obsolescence allowance	(409)	(55)
	<b>\$ 4,698</b>	<b>\$ 4,877</b>

Amounts credited to the allowance for obsolete inventory and charged to cost of sales amounted to \$131 and \$109 for the three month period ended September 30, 2010 and 2009, and \$354 and \$184 for the nine month period ended September 30, 2010 and 2009, respectively.

**4. Costs and Estimated Earnings on Uncompleted Contracts**

<b>\$ in thousands</b>	<b>September 30, 2010</b>	<b>December 31, 2009</b>
Costs incurred on uncompleted contracts	\$ 74,433	\$ 74,908
Estimated earnings	15,175	16,897
	<b>89,608</b>	<b>91,805</b>
Less billings to date	(87,286)	(91,497)
	<b>\$ 2,322</b>	<b>\$ 308</b>

Included in the accompanying consolidated balance sheets under the following captions:

Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 9,587	\$ 10,681
Billings in excess of costs and estimated earnings on uncompleted contracts	(7,265)	(10,373)

\$ 2,322 \$ 308

**Table of Contents****CECO ENVIRONMENTAL CORP.****NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

Revenues from contracts, representing the majority of our revenues, are recognized on the percentage of completion method, measured by the percentage of contract costs incurred to date compared to estimated total contract costs for each contract. This method is used because management considers contract costs to be the best available measure of progress on these contracts.

Our remaining revenues are recognized when risk and title passes to the customer, which is generally upon shipment of product. Our contracts have various lengths to completion ranging from a few days to several months. We anticipate that a majority of our current contracts will be completed within the next twelve months.

**5. Goodwill and Intangible Assets**

\$ in thousands Goodwill / Tradename	Nine months ended September 30, 2010		Year ended December 31, 2009	
	Goodwill	Tradename	Goodwill	Tradename
Beginning balance	\$ 14,591	\$ 3,209	\$ 31,116	\$ 3,165
Impairment			(17,110)	
Foreign currency adjustments	46	6	585	44
	\$ 14,637	\$ 3,215	\$ 14,591	\$ 3,209

Intangible assets    finite life	September 30, 2010		December 31, 2009	
	Cost	Accum. Amort.	Cost	Accum. Amort.
Patents	\$ 1,414	\$ 1,089	\$ 1,412	\$ 1,024
Customer lists	1,644	928	1,644	685
Employment contracts	420	376	420	305
Other	132	122	130	122
	\$ 3,610	\$ 2,515	\$ 3,606	\$ 2,136

We complete an annual (or more often if circumstances require) impairment test for our indefinite life intangible assets. In performing these assessments, the carrying value of the asset is considered impaired if the fair value is less than the carrying value of the asset. If this occurs, an impairment charge is recorded for the amount by which the carrying value of the asset exceeds its fair value.

Also as required by current accounting rules, we complete an annual (or more often if circumstances require) impairment test for our goodwill. In performing these assessments, the carrying value of the reporting unit is compared to its estimated fair value, as calculated by the discounted present value of cash flow method. If the estimated fair value of the reporting unit is less than its carrying value, an impairment charge is recorded for the amount by which the carrying value of the goodwill exceeds its calculated implied fair value. The Company's fourth quarter 2009 annual evaluation for goodwill impairment indicated an impairment of the goodwill for four of the Company's reporting units. As a result, the Company estimated the implied fair value of the goodwill of these reporting units compared to carrying amounts and recorded total

## Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

impairment charges of \$17.1 million at December 31, 2009 to impair a portion of the goodwill recorded on these reporting units. The decrease in the fair value of the reporting units was due to deteriorating market conditions resulting from the global economic downturn. No impairment of goodwill was identified related to the Company's other reporting units. No additional impairment was recorded in the nine month period ended September 30, 2010.

**Table of Contents**

**CECO ENVIRONMENTAL CORP.**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

Major factors that influence our cash flow analyses are our estimates for future revenue and expenses associated with the reporting units. This is the most sensitive of our estimates related to our fair value calculations. Other factors considered in our fair value calculations include assumptions as to the business climate, industry and economic conditions. These assumptions are subjective and different estimates could have a significant impact on the results of our analyses.

Finite life intangible assets are comprised of patents, customer lists and employment contracts. For all amortizable intangible assets, if any events or changes in circumstances occur that indicate possible impairment, our impairment review is based on an undiscounted cash flow analysis. Impairment occurs when the carrying value of the assets exceeds the future undiscounted cash flows. When impairment is indicated, the estimated future cash flows are then discounted to determine the estimated fair value of the asset and an impairment charge is recorded for the difference between the carrying value and the net present value of estimated future cash flows. The Company also evaluates the remaining useful life each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization. If the estimate of an intangible asset's remaining useful life is changed, the remaining carrying amount of the intangible asset is amortized prospectively over that revised remaining useful life.

Amortization of finite life intangibles is on a straight line basis and amortization expense for the three months ended September 30, 2010 and 2009 was \$117,000 and \$139,000 respectively and for the nine months ended September 30, 2010 and 2009 was \$377,000 and \$618,000 respectively. Over the next five years amortization expense for these finite life intangible assets will be \$117,000 for the remainder of 2010, \$424,000 in 2011, \$316,000 in 2012, \$130,000 in 2013 and \$69,000 in 2014.

**6. Business Segment Information**

Our structure and operational integration results in one reportable segment that focuses on engineering, designing, building and installing systems that remove airborne contaminants from industrial facilities, as well as equipment that controls emissions from such facilities. Accordingly, the consolidated financial statements herein reflect the operating results of the reportable segment.

**7. Earnings Per Share**

For the three and nine months ended September 30, 2010, basic weighted average common shares outstanding were 14,320,188 and 14,304,554, respectively and for the three and nine months ended September 30, 2009, basic weighted average common shares outstanding were 14,241,594 and 14,214,065, respectively. For the three and nine months ended September 30, 2010, diluted common shares outstanding were 17,128,215 and 14,396,965, respectively and for the three and nine months ended September 30, 2009, diluted common shares outstanding were 14,241,594 and 14,214,065, respectively.

Effective January 1, 2009, the Company adopted ASC 260-10-65-2, Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities. Non-vested shares with non-forfeitable dividend rights are considered participating securities and, thus, subject to the two-class method pursuant to ASC Topic 260, Earnings per Share, when computing basic and diluted EPS. Losses are only allocable to participating securities if the holder has the contractual obligation to share in the losses of the Company.

Holders of our restricted stock awards participate in nonforfeitable dividend rights on a one-for-one basis with holders of common stock. Holders of these awards are not obligated to share in losses of the Company. Therefore, these share awards are included in the computation of basic earnings (loss) per share during periods of net income using the two-class method, but are excluded from such computation in periods of net loss. Should the Company declare a dividend on its common stock, the related dividend on shares of unvested restricted stock that are not expected to vest would be recorded as additional compensation expense and therefore excluded from the two-class method computations; however, no such dividends have been declared to date. Undistributed earnings included in the two-class method computations are allocated equally to each share of common stock outstanding, including all shares of unvested restricted common shares. For the three month and nine



## Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

month periods ended September 30, 2010 the weighted average number of non-vested restricted share awards which were included in the basic weighted average common shares outstanding totaled 1,449 and 28,468 respectively. For the three month and nine months periods ended September 30, 2009, 46,085 and 83,171 non-vested restricted share awards were excluded from the computation of basic and diluted weighted average common shares outstanding due to the reported net loss for the periods.

**Table of Contents****CECO ENVIRONMENTAL CORP.****NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

We consider outstanding options and warrants in computing diluted net income per share only when they are dilutive. For the three and nine month periods ended September 30, 2010, 480,000 and 599,000, respectively, outstanding options and warrants were excluded from the computation of diluted weighted average common shares outstanding as their effect would have been anti-dilutive. For each of the three and nine month periods ended September 30, 2009, 1,283,105 outstanding options and warrants were excluded from the computation of diluted weighted average common shares outstanding as their effect would have been anti-dilutive. Additionally, pursuant to the if-converted method, net income used for purposes of computing diluted earnings per share is adjusted for the net impact of interest and other items related to the Convertible Subdebt Note and Convertible Investor Notes (see Note 8) unless the effect is anti-dilutive. The net impact of interest and other items related to the Convertible Subdebt Note and Investor Notes for the three and nine month periods ended September 30, 2010 was expense of approximately \$97,000 and \$296,000 respectively. Net income was adjusted by this net impact for the three month period ended September 30, 2010 and 2,700,000 shares were included in the computation of diluted weighted average common shares outstanding. Because of an anti-dilutive effect, net income (loss) was not adjusted for this net impact for the nine month period ended September 30, 2010 and 2,700,000 shares were excluded from the computation of diluted weighted average common shares outstanding. The net impact of interest and other items related to the Convertible Subdebt Note for the three and nine month periods ended September 30, 2009 was expense of approximately \$203,000 and \$294,000, respectively. Because of an anti-dilutive effect, the net loss was not adjusted for this net impact for the three and nine month periods ended September 30, 2009.

**8. Debt**

Total bank debt was \$3.1 million at September 30, 2010 and \$2.7 million at December 31, 2009. The bank debt at September 30, 2010 consists of \$1.1 million due on the revolving lines of credit and a term note totaling \$2.0 million. Our current credit facility with Fifth Third Bank (the Bank Facility), as amended, includes a revolving line of credit of up to \$20 million, including letters of credit, limited to a borrowing base amount computed as 70% of eligible accounts receivable, 50% of unbilled revenues up to \$2.0 million, plus 50% of eligible inventories up to \$7.5 million. Unused credit availability under our \$20.0 million revolving line of credit at September 30, 2010 was \$8.0 million. Interest on the outstanding borrowings is charged at the daily LIBOR rate plus 4.0% or the tranche LIBOR rate plus 3.5% for the revolver and the daily LIBOR rate plus 4.25% or the tranche LIBOR rate plus 3.75% for the term note. The weighted average interest rate under the Bank Facility as of September 30, 2010 and September 30, 2009 was 4.07% and 3.44%, respectively.

We entered into our current Bank Facility on December 29, 2005 with Fifth Third Bank. The Bank Facility was amended on various dates and fees paid for these amendments were deferred and are being amortized over the remaining term of the Bank Facility.

On August 6, 2010, the Company entered into an amended and restated credit agreement effective as of June 30, 2010, which amends and restates in its entirety the Bank Facility and extends the termination date of the Line of Credit to April 1, 2013 and the term loan to April 1, 2014. The amendment and restatement also increases the limit on letters of credit from \$5.0 million to \$10.0 million, resets the pricing grid to level one which temporarily increases our interest rates by 0.5% until the next pricing grid determination date of December 31, 2010, at which time the pricing level will be re-determined based on the Company's trailing twelve month fixed charge ratio. Fees of \$23,000 were paid for this amendment.

Terms of the Bank Facility, as amended, include financial covenants which require compliance at June 30, 2010 and each quarter through March 31, 2013. The maximum capital expenditures financial covenant is \$2,500,000 per year. The minimum Fixed Charge Coverage Ratio is 2.5:1.0 for each quarter through the quarter ended June 30, 2010 and 1.25:1.0 thereafter. The maximum funded debt to EBITDA covenant is 3.0 to 1. Our Bank Facility also contains cross-default provisions with respect to our subordinated debt. Also, if we fail to pay (after grace periods) any other debt or lease that, individually or in the aggregate involves indebtedness in excess of \$100,000, and such default gives any creditor or lessor the right to accelerate the maturity of any such indebtedness or lease payments, then absent a waiver from the lender, it would result in a default under our Bank Facility and the acceleration of the maturity of outstanding debt under our Bank Facility. As of September 30, 2010, we were in compliance with all related financial and other restrictive covenants, and expect continued compliance. In the future, if we cannot comply with the terms of the Bank Facility covenants it will be necessary for us to obtain a waiver or renegotiate our loan covenants, and there

## Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

can be no assurance that such negotiations would be successful. In the event that we are not successful in obtaining a waiver or an amendment, we would be declared in default, which could cause all amounts owed to be immediately due and payable.

**Table of Contents****CECO ENVIRONMENTAL CORP.****NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

On August 14, 2008, the Company issued a Subordinated Convertible Promissory Note (the Convertible Subdebt Note) in the amount of Canadian \$5.0 million to Icarus Investment Corp. (Icarus), which is controlled by Phillip DeZwirek, our Chairman and former CEO, and Jason DeZwirek, our Secretary and one of our Directors. The Convertible Subdebt Note provided for interest to accrue at the rate of 10% per annum in 2008, 11% per annum in 2009, and 12% per annum commencing January 1, 2010 until paid. The outstanding principal and accrued interest under the Convertible Subdebt Note was convertible at any time into common stock of the Company at a per share price of \$4.75 which was the closing price immediately preceding its issuance. We repaid Canadian \$3.7 million under the Convertible Subdebt Note on March 31, 2009 and fully repaid the outstanding balance of \$1.2 million on November 26, 2009.

On May 15, 2009, the Company issued a Promissory Note (Note) to Icarus in the amount of \$3.0 million. The Note, which was subordinated to the Company's Bank Facility, bore interest at 12% per annum with interest payable monthly. The maturity date of the note was the earlier of May 15, 2012 or six months after repayment of the Bank Facility. At the option of Icarus, the note was repayable in Canadian funds with a stated conversion rate of 1.1789, or CAD \$3.5 million, representing the conversion rate at the issuance date of the Note. In accordance with ASC 815 Derivatives and Hedging, this option was bifurcated and recorded at fair value. Gains and losses resulting from the revaluation of this liability were included in other income (expense) in the consolidated statements of operations. The Note and accrued interest was fully repaid on November 26, 2009 in the amount of \$3.3 million.

On November 26, 2009, the Company issued \$10.8 million principal amount subordinated convertible promissory notes to a group of investors (the Investor Notes) which includes related parties: Icarus (\$2,200,000), Jason DeZwirek (\$800,000), and Harvey Sandler Revocable Trust (\$800,000), which trust owns over 10% of our outstanding common stock. Interest accrues under the Investor Notes at the annual rate of 6% and is payable as of the end of each calendar quarter. Interest paid for the three and nine month periods was \$163,000 and \$485,000 respectively. We used the proceeds of the Investor Notes to repay all of our previously existing subordinated debt in the amount of approximately \$4.5 million, which debt was accruing interest at rates between 11-12%. The balance of the proceeds will be used for general working capital. Fees of \$320,000 were paid for the issuance of this debt and are being amortized over the term of the Investor Notes.

The Investor Notes are due on November 26, 2014 and are not repayable prior to maturity except upon a change of control, or upon the consent of the holder. The outstanding principal amount of the Investor Notes or any portion thereof, but not the interest, is convertible at the holder's option, at any time after the issuance of the Investor Notes at a conversion price of \$4.00 per share, such price being greater than the Company's share price at the date of issuance of the Investor Notes. Following three years from the date of the Investor Notes, if the closing price of the common stock of the Company is greater than \$8.00 for five consecutive days, the Company can cause conversion of the Investor Notes.

**9. Employee Benefit Plans**

We sponsor a non-contributory defined benefit pension plan for certain union employees. The plan is funded in accordance with the funding requirements of the Employee Retirement Income Security Act of 1974.

We also sponsor a post retirement health care plan for office employees retiring before January 1, 1990. The plan allows retirees who have attained the age of 65 to elect the type of coverage desired.

Retirement and health care plan expense is based on valuations performed by plan actuaries as of the beginning of each fiscal year. The components of the expense consisted of the following:

**Three Months Ended  
September 30,**

**Nine Months Ended  
September 30,**

Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

<b>\$ in thousands</b>	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Retirement plan:				
Service cost	\$ 54	\$ 44	\$ 162	\$ 132
Interest cost	94	95	282	285
Expected return on plan assets	(94)	(80)	(282)	(240)
Amortization of prior service cost	2	2	6	6
Amortization of net actuarial loss	54	61	162	183
<b>Net periodic benefit cost</b>	<b>\$ 110</b>	<b>\$ 122</b>	<b>\$ 330</b>	<b>\$ 366</b>

**Table of Contents****CECO ENVIRONMENTAL CORP.****NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)**

\$ in thousands	Three Months Ended		Nine Months Ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
<b>Health care plan:</b>				
Interest cost	\$ 4	\$ 4	\$ 12	\$ 12
Amortization of gain	(1)	(1)	(3)	(3)
Net periodic benefit cost	\$ 3	\$ 3	\$ 9	\$ 9

As of September 30, 2010 we have made contributions to our defined benefit plans totaling \$169,000. We anticipate contributing \$58,000 to fund the pension plan during the remainder of fiscal 2010.

The funded status of our post-retirement health care plan is calculated on the projected postretirement obligation.

**10. Stock-Based Compensation**

The Company recognizes compensation expense for stock-based awards, measured at the fair value of the awards at the grant date. The Company recognized expense of approximately \$228,000 and \$239,000 during the quarters ended September 30, 2010 and 2009, respectively, and \$694,000 and \$711,000 for the nine months ended September 30, 2010 and 2009, respectively.

**11. Income Taxes**

The Company files income tax returns in various federal, state and local jurisdictions. The Company is no longer subject to federal, state and local income tax examinations by tax authorities for years before 2006.

As of September 30, 2010 and December 31, 2009, the liability for uncertain tax benefits totaled approximately \$387,000. Included in these balances is a \$148,000 tax position for which the ultimate outcome is highly certain. The Company included interest and penalties in the unrecognized tax benefit as of September 30, 2010 and December 31, 2009.

**12. Comprehensive Income (Loss)**

Comprehensive income (loss) consists of net income (loss), changes in the pension liability that do not directly impact net earnings, if any during the period, and translation gains and losses for foreign operations.

Comprehensive income of \$769,000 included net income of \$683,000 and a translation gain of \$86,000 for the three month period ended September 30, 2010, and comprehensive (loss) of \$(263,000) for the three month period ended September 30, 2009 included net (loss) of \$(678,000) and a translation gain of \$415,000.

Comprehensive income of \$1,435,000 included net income of \$1,362,000 and a translation gain of \$73,000 for the nine month period ended September 30, 2010, and comprehensive (loss) of \$(173,000) for the nine month period ended September 30, 2009 included net (loss) of \$(948,000) and a translation gain of \$775,000.

**13. Product Warranties**

The Company's warranty reserve is to cover the products sold and is principally at our Effox subsidiary. The warranty accrual is based on historical claims information. The warranty reserve is reviewed and adjusted as necessary on a quarterly basis. Warranty accrual is not significant at the Company's other operations due to the nature of the work which includes installation and testing. The change in accrued warranty expense is summarized in the following table:

\$ in thousands	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Beginning balance	\$ 472	\$ 511	\$ 498	\$ 574
Provision	35	138	235	219
Payments	(52)	(158)	(278)	(302)
Ending balance	\$ 455	\$ 491	\$ 455	\$ 491

**Table of Contents****CECO ENVIRONMENTAL CORP.****NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****14. Financial Instruments**

Our financial instruments consist primarily of investments in cash and cash equivalents, receivables and certain other assets, such as cash surrender life insurance, as well as obligations under accounts payable, long-term debt and subordinated notes. The carrying values of these financial instruments approximate fair value at September 30, 2010 and December 31, 2009.

Most of the debt obligations approximate their reported carrying amounts based on future payments discounted at current interest rates for similar obligations or interest rates which fluctuate with the market.

***Concentrations of credit risk:***

Financial instruments that potentially subject us to credit risk consist principally of cash and accounts receivable. We maintain cash and cash equivalents with various major financial institutions.

We perform periodic evaluations of the financial institutions in which our cash is invested. Concentrations of credit risk with respect to trade and contract receivables are limited due to the large number of customers and various geographic areas. Additionally, we perform ongoing credit evaluations of our customers' financial condition.

**15. Discontinued Operations**

During 2009, the Company discontinued the operations of H.M. White. The Company terminated its facility lease in Detroit, Michigan and all property and equipment held by H.M. White was sold at net book value to its former owner. Accordingly, there was no gain or loss associated with the sale of H.M. White's assets.

The results of H.M. White are presented as discontinued operations for all periods in the consolidated financial statements. The Company did not allocate general corporate interest expense to H.M. White.

Operating results of discontinued operations are as follows:

<b>\$ in thousands</b>	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Net sales	\$ 14	\$ 1,238	\$ 447	\$ 4,105
Income (loss) from discontinued operations, before income tax	\$ 16	\$ (45)	\$ (249)	\$ (563)
Income tax expense (benefit)	6	(16)	(94)	(197)
Income (loss) from discontinued operations	\$ 10	\$ (29)	\$ (155)	\$ (366)

Assets and liabilities related to discontinued operations consisted of the following:



Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

<b>\$ in thousands</b>	<b>September 30, 2010</b>	<b>December 31, 2009</b>
<b>Assets</b>		
Accounts receivable	\$ 103	\$ 1,356
Inventories		37
Costs and estimated earnings in excess of billings on uncompleted contracts	33	299
Prepaid expenses and other	145	185
 Total current assets of discontinued operation	 281	 1,877
Property and equipment, net		57
 Total assets of discontinued operation	 \$ 281	 \$ 1,934
<b>Liabilities</b>		
Accounts payable and accrued expenses	\$ 7	\$ 533
Billings in excess of costs and estimated earnings on uncompleted contracts		115
 Total current liabilities of discontinued operations	 \$ 7	 \$ 648

**Table of Contents****CECO ENVIRONMENTAL CORP.****NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(unaudited)****16. Property and Equipment Held for Sale**

In order to operate at a higher utilization rate and to increase operational efficiency, the Company determined to shift production to its North American facilities by scaling down the Kirk & Blum Contracting Services and Fabrication production at its plants in Cincinnati, Ohio, Indianapolis, Indiana and Lexington, Kentucky and migrating such production to its facilities in Louisville, Kentucky; Columbia, Tennessee; Greensboro, North Carolina and Canton, Mississippi. The Company is currently negotiating the sale of the Cincinnati, Indianapolis and Lexington plants and believes that the buildings and land will be sold within a one year period.

\$ in thousands	September 30, 2010			
	Cincinnati	Indianapolis	Lexington	total
Land	\$ 825	\$ 320	\$ 240	\$ 1,385
Building and improvements, net	1,861	530	695	3,086
Property and equipment held for sale	\$ 2,686	\$ 850	\$ 935	\$ 4,471

**Table of Contents**

**CECO ENVIRONMENTAL CORP.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS**

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

Our consolidated statements of operations for the three-month and nine-month periods ended September 30, 2010 and 2009 reflect our operations consolidated with the operations of our subsidiaries.

We are one of the leading providers of air-pollution control products and services. Our revenues are generated by our services of engineering and designing as well as building equipment, and installing systems that capture, clean and destroy airborne contaminants from industrial facilities and equipment that controls emissions from such facilities. We have a diversified base of more than 3,000 active customers among a myriad of industries including aerospace, brick, cement, ceramics, metalworking, ethanol, printing, paper, food, foundry, power, refining, mining, metal plating, woodworking, chemicals, tobacco, glass, automotive, and pharmaceuticals. Therefore, our business is not concentrated in a single industry or customer.

On February 15, 2010, we appointed Jeffrey Lang as our Chief Executive Officer. Mr. Lang has more than thirty years of executive operating management experience including Executive Vice President, Chief Operating Officer at McJunkin Red Man Corp. and twenty five years at Ingersol Rand including leading their Industrial Air Solutions sales, service and operations for North America. Management has been closely monitoring the current economic conditions especially as some of our customers have announced that they are facing financial distress which may adversely affect our revenues and accounts receivable. In a weak economy customers tend to lengthen the time between inquiry and order or may defer purchasing our products and services until the economy recovers.

In light of this reduction in demand and the new management expertise of Jeff Lang, we have focused on reducing costs throughout the company, including plant rationalizations and reductions in overhead and general and administrative expenses.

Early in the third quarter of 2010, we decided to shift production from our North American facilities by scaling down the Kirk & Blum Contracting Services and Fabrication production at our plants in Cincinnati, Ohio, Indianapolis, Indiana and Lexington, Kentucky and migrating such production to its facilities in Louisville, Kentucky; Columbia, Tennessee; Greensboro, North Carolina and Canton, Mississippi. We are currently negotiating the sale of the Cincinnati, Indianapolis and Lexington plants and believe that the buildings and land will be sold within a one year period, although there can be no assurance that all or any such sales will occur by such time.

***Operations Overview***

Our contracts are obtained either through competitive bidding or as a result of negotiations with our customers. Contract terms offered by us are generally dependent on the complexity and risk of the project as well as the resources that will be required to complete the project. For example, a contract that can be performed primarily by subcontractors and that does not require us to use our fabrication and assembly facilities can be quoted at a lower gross margin than a more typical contract that will require additional factory overhead and administrative expenses. Our focus is on increasing our operating margins as well as our gross margin percentage which translates into higher net income.

***How We Manage our Business***

We operate under a hub and spoke business model in which executive management, finance, administrative and marketing staff serves as the hub while the sales channels serve as spokes. We use this model throughout our operations. This has provided us with certain efficiencies over a more decentralized model.

Although we discuss four principal product lines, our operating units function as internal customers and suppliers of each others' products and services and as such, products and services are intermingled in one major project. As a result, it is not reasonably possible to segregate revenues to external customers, operating profits or identifiable assets by product line.

## Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

During 2009, we discontinued the operations of our subsidiary, H.M. White, Inc. We terminated our facility lease in Detroit, Michigan and all property and equipment held by H.M. White was sold at net book value to its former owner.

The results of H.M. White are presented as discontinued operations for the periods presented.

**Table of Contents****CECO ENVIRONMENTAL CORP.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION****AND RESULTS OF OPERATIONS**

Our condensed consolidated statements of operations for the three-month and nine-month periods ended September 30, 2010 and 2009 are as follows:

(\$ s in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net sales from continuing operations	\$ 33.9	\$ 32.0	\$ 103.7	\$ 102.4
Cost of sales from continuing operations	26.1	25.1	79.5	79.3
Gross profit from continuing operations	\$ 7.8	\$ 6.9	\$ 24.2	\$ 23.1
Percent of sales	23.0%	21.6%	23.3%	22.6%
Selling and administrative expenses from continuing operations	\$ 6.6	\$ 7.0	\$ 20.8	\$ 21.8
Percent of sales	19.5%	21.9%	20.1%	21.3%
Operating income (loss) from continuing operations	\$ 1.6	\$ (0.3)	\$ 3.6	\$ 0.7
Percent of sales	4.7%	(0.9)%	3.5%	0.7%

Consolidated net sales from continuing operations for the third quarter increased 5.9% or \$1.9 million to \$33.9 million in 2010 compared to \$32.0 million in 2009. Consolidated net sales from continuing operations for the first nine months of 2010 were \$103.7 million, an increase of \$1.3 million or 1.3% compared to \$102.4 million in 2009. The overall increase in revenues for the three months ended September 30, 2010 was primarily the result of a 25% increase in parts group sales coupled with a 4% increase in contracting revenues and a small decrease in equipment revenues. The parts group sales have increased significantly due to smaller contractors buying components parts instead of producing them in house. The comparative nine month increase in net sales was also attributable to significant increases in the parts group revenues which increased 29%, plus a 5% increase in equipment sales offset by a 23% decline in contracting sales.

New orders booked from continuing operations were \$35.1 million during the third quarter of 2010 and \$93.5 million for the first nine months of 2010, as compared to \$25.3 million during the third quarter of 2009 and \$92.4 million in the first nine months of 2009. The increase in bookings for the quarter was due to increased demand for our products in the current improving economy.

Third quarter 2010 gross profit from continuing operations increased by \$0.9 million or 13% to \$7.8 million compared to a gross profit from continuing operations of \$6.9 million during the same period in 2009. Gross profit for the quarter as a percentage of sales increased to 23.0% from 21.6%. This increase was primarily the result of an increase in the proportion of sales of higher margin component parts sales to total sales and improving margins in the contracting group. The parts group sales, before intercompany eliminations, were 13% of total sales for the three months of 2010 compared to 10% of total sales for the same period in 2009 and the equipment group sales, before intercompany eliminations, were 61% of total sales for the third quarter of 2010 compared to 63% sales for the third quarter of 2009. The contracting group revenues as a percent of total sales increased slightly in 2010.

For the first nine months of 2010, gross profit increased by \$1.1 million or 4.8% to \$24.2 million compared to \$23.1 million for the same period in 2009. Gross profit as a percentage of sales for the nine month period increased by 0.7 percentage points to 23.3% from 22.6% in 2009. This increase was primarily the result of an increase in the proportion of sales of higher margin component parts and equipment sales to total sales and improving margins in the contracting group. The parts group sales, before intercompany eliminations, were 12% of total sales for the first nine months of 2010 compared to 9% of total sales for the same period in 2009 and the equipment group sales, before intercompany eliminations, were 62% of total sales for the third quarter of 2010 compared to 58% sales for the third quarter of 2009. The contracting group revenues as a percent of total sales declined from 32% in 2009 to 25% in 2010.

## Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

Selling and administrative expenses decreased by \$0.4 million, or 5.7%, from \$7.0 million to \$6.6 million during the third quarter and decreased by \$1.0 million, or 4.6%, from \$21.8 million to \$20.8 million during the first nine months of 2010 compared to 2009. The three and nine month periods ended September 30, 2010 reflect significant reductions in wages and related fringes due to staff reductions made as part of our streamlining and consolidation efforts. Selling and administrative expense as a percentage of sales decreased from 21.9% to 19.5% for the quarter ended September 30, 2010 and decreased from 21.3% to 20.1% for the nine months ended September 30, 2010. The decrease in selling and administrative expenses as a percentage of sales is primarily due to reduced expenses as discussed above.

Amortization expense remained constant at \$0.1 million during the third quarter of 2010 compared to the same period in 2009 and decreased by \$0.2 million to \$0.4 million in the first nine months of 2010 compared to \$0.6 million in the same period of 2009. These decreases were the result of certain definite life intangibles related to earlier acquisitions becoming fully amortized.

**Table of Contents**

**CECO ENVIRONMENTAL CORP.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**

**AND RESULTS OF OPERATIONS**

We continue to optimize our factory footprint to eliminate excess capacity. As part of this process we have recently closed our contracting group manufacturing facilities in Lexington, Kentucky, Indianapolis, Indiana and Cincinnati, Ohio. The gain from the sale at auction of operating machinery and equipment related to these closures was \$0.3 million during the third quarter of 2010. Additionally, we realized a gain of approximately \$0.3 from the sale of our Buell-Classifier Division which was sold in its entirety to another company. The results of operations for this division were not significant to the Company. We do not anticipate any future losses or restructuring charges from these closures as the remaining machinery and equipment has been transferred to other facilities and the anticipated selling prices of the properties is expected to be in excess of the net book value of the remaining assets. We have shifted production to our other more productive and cost effective facilities and we believe these moves will save us approximately \$2.0 million in annualized expenses going forward which will lower our cost of goods sold and continue to improve our gross margins.

Operating income increased by approximately \$1.9 million to \$1.6 million in the third quarter of 2010 compared to an operating loss of \$0.3 million during the same quarter of 2009. The impact of higher revenues and higher margins due to changing product mix in the third quarter as well as reduced selling and administrative costs were the primary factors for the increase in operating income. This increase in operating income was also due to a \$600,000 gain on equipment from the sale of one small division and sales of machinery and equipment related to the closed contracting facilities. Operating income for the first nine months of 2010 increased by \$2.9 million to \$3.6 million compared to operating income of \$0.7 million during the same period of 2009. This increase in operating income for the nine months was also due to the \$600,000 gain on equipment discussed above as well as a \$200,000 decrease in amortization expense which also increased operating income. This increase was also due to the impact of increased revenues and higher margins due to changing product mix as well as reduced selling and administrative costs.

Other expense of \$0.1 million for the three months ended September 30, 2010 consists primarily of losses on foreign currency transactions compared to \$0.4 million in 2009. For the nine months ended September 30, 2010, other expense of \$0.1 also consisted primarily of foreign currency transaction losses compared to \$0.5 million for the same period in 2009, which was primarily the result of unrealized foreign currency losses related to our recently retired subordinated debt which was denominated in Canadian currency.

Interest expense for the three months ended September 30, 2010 remained constant at \$0.3 million compared to September 30, 2009. Interest expense for the nine months ended September 30, 2010 decreased slightly to \$0.9 million from \$1.0 million for the first nine months of 2010.

Federal and state income tax expense was \$0.5 million during the third quarter of 2010 compared to a tax benefit of \$0.4 million during the third quarter of 2009. Federal and state income tax expense was \$1.0 million for the first nine months of 2010 compared to a tax benefit of \$0.3 million in 2009.

The federal and state income tax expense for the three months ended September 30, 2010 was 42% of income from continuing operations and 40% for the nine months ended September 30, 2010. Our effective income tax rate is affected by certain permanent timing differences including non-deductible compensation expense related to the issuance of incentive stock options and tax shortfalls related to restricted stock vesting at prices lower than the date granted as well as foreign income which is taxed at a lower rate. The federal and state income tax benefit for the three months ended September 30, 2009 was 35% of income from operations before income taxes.

Net income from continuing operations for the quarter ended September 30, 2010 was \$0.7 million compared with a net loss from continuing operations of \$0.6 million for the same period in 2009. Net income from continuing operations for the nine months ended September 30, 2010 was \$1.5 million compared with a net loss of \$0.6 million for the same period in 2009.

Net income for the quarter ended September 30, 2010 was \$0.7 million compared with a net loss from continuing operations of \$0.7 million for the same period in 2009. Net income for the nine months ended September 30, 2010 was \$1.4 million compared with a net loss of \$0.9 million for the same period in 2009.

## Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

This increase in net income for the quarter and for the nine months ended September 30, 2010 was the result of the previously discussed factors.

### **Backlog**

Our backlog consists of the amount of revenues we expect from full performance of orders we have received that have not been completed for products and services we expect to substantially ship and deliver within the next 12 months. There can be no assurances that backlog will be replicated, increased or translated into higher revenues in the future.



**Table of Contents**

**CECO ENVIRONMENTAL CORP.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**

**AND RESULTS OF OPERATIONS**

Our backlog from continuing operations, as of September 30, 2010 was \$56.3 million compared to \$66.5 million as of December 31, 2009 and \$56.1 million as of September 30, 2009. The success of our business depends on a multitude of factors related to our backlog and the orders secured during the subsequent period(s). Certain contracts are highly dependent on the work of contractors and other subcontractors participating in a project, over which we have no or limited control, and their performance on such project could have an adverse effect on the profitability of our contracts. Delays resulting from these contractors and subcontractors, changes in the scope of the projects, weather, and labor availability also can have an affect on a contract's profitability.

**Financial Condition, Liquidity and Capital Resources**

Our principal sources of liquidity are cash flow from operations and available borrowings under our revolving credit facility. Our principal uses of cash are operating costs, debt service, payment of interest on our outstanding senior debt, and convertible subordinated debt plus working capital and other general corporate requirements.

At September 30, 2010 and December 31, 2009, cash and cash equivalents totaled \$4.2 million and \$1.4 million respectively. Generally, we do not carry significant cash and cash equivalent balances because excess amounts are used to pay down our revolving line of credit. Cash balances may fluctuate from time to time due to uncollected funds not being immediately swept against the credit line balance.

Total bank debt at September 30, 2010 was \$3.1 million and \$2.7 million at December 31, 2009. The bank debt at September 30, 2010 consists of \$1.1 million due on the revolving lines of credit and a term note totaling \$2.0 million. Our current credit facility with Fifth Third Bank (the Bank Facility), as amended, includes a revolving line of credit of up to \$20 million, including letters of credit, limited to a borrowing base amount computed as 70% of eligible accounts receivable, 50% of unbilled revenues up to \$2.0 million, plus 50% of eligible inventories up to \$7.5 million. Unused credit availability under our \$20.0 million revolving line of credit at September 30, 2010 was \$8.0 million. Interest on the outstanding borrowings is charged at the daily LIBOR rate plus 4.0% or the tranche LIBOR rate plus 3.5% for the revolver and the daily LIBOR rate plus 4.25% or the tranche LIBOR rate plus 3.75% for the term note. The weighted average interest rate under the Bank Facility as of September 30, 2010 and September 30, 2009 was 4.07% and 3.44%, respectively.

We entered into our current Bank Facility on December 29, 2005 with Fifth Third Bank. The Bank Facility was amended on various dates and fees paid for these amendments were deferred and are being amortized over the remaining term of the Bank Facility.

On August 6, 2010, the Company entered into an amended and restated credit agreement effective as of June 30, 2010, which amends and restates in its entirety the Bank Facility and extends the termination date of the Line of Credit to April 1, 2013 and the term loan to April 1, 2014. The amendment and restatement also increases the limit on letters of credit from \$5.0 million to \$10.0 million, resets the pricing grid to level one which temporarily increases our interest rates by 0.5% until the next pricing grid determination date of December 31, 2010, at which time the pricing level will be re-determined based on the Company's trailing twelve month fixed charge ratio. Fees of \$23,000 were paid for this amendment.

Terms of the Bank Facility, as amended, include financial covenants which require compliance at June 30, 2010 and each quarter through March 31, 2013. The maximum capital expenditures financial covenant is \$2,500,000 per year. The minimum Fixed Charge Coverage Ratio is 2.5:1.0 for each quarter through the quarter ended June 30, 2010 and 1.25:1.0 thereafter. The maximum funded debt to EBITDA covenant is 3.0 to 1. Our Bank Facility also contains cross-default provisions with respect to our subordinated debt. Also, if we fail to pay (after grace periods) any other debt or lease that, individually or in the aggregate involves indebtedness in excess of \$100,000, and such default gives any creditor or lessor the right to accelerate the maturity of any such indebtedness or lease payments, then absent a waiver from the lender, it would result in a default under our Bank Facility and the acceleration of the maturity of outstanding debt under our Bank Facility. As of September 30, 2010, we were in compliance with all related financial and other restrictive covenants, and expect continued compliance. In the future, if we cannot comply with the terms of the Bank Facility covenants it will be necessary for us to obtain a waiver or renegotiate our loan covenants, and there can be no assurance that such negotiations would be successful. In the event that we are not successful in obtaining a waiver or an amendment,

## Edgar Filing: CECO ENVIRONMENTAL CORP - Form 10-Q

we would be declared in default, which could cause all amounts owed to be immediately due and payable.

On August 14, 2008, the Company issued a Subordinated Convertible Promissory Note (the Convertible Subdebt Note ) in the amount of Canadian \$5.0 million to Icarus Investment Corp. ( Icarus ), which is controlled by Phillip DeZwirek, our Chairman and former CEO, and Jason DeZwirek, our Secretary and one of our Directors. The Convertible Subdebt Note provided for interest to accrue at the rate of 10% per annum in 2008, 11% per annum in 2009, and 12% per annum commencing January 1, 2010 until paid. The outstanding principal and accrued interest under the Convertible Subdebt Note was convertible at any time into common stock of the Company at a per share price of \$4.75 which was the closing price immediately preceding its issuance. We repaid Canadian \$3.7 million under the Convertible Subdebt Note on March 31, 2009 and fully repaid the outstanding balance of \$1.2 million on November 26, 2009.

**Table of Contents****CECO ENVIRONMENTAL CORP.****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION****AND RESULTS OF OPERATIONS**

On May 15, 2009, the Company issued a Promissory Note ( Note ) to Icarus in the amount of \$3.0 million. The Note, which was subordinated to the Company's Bank Facility, bore interest at 12% per annum with interest payable monthly. The maturity date of the note was the earlier of May 15, 2012 or six months after repayment of the Bank Facility. At the option of Icarus, the note was repayable in Canadian funds with a stated conversion rate of 1.1789, or CAD \$3.5 million, representing the conversion rate at the issuance date of the Note. In accordance with ASC 815

Derivatives and Hedging , this option was bifurcated and recorded at fair value. Gains and losses resulting from the revaluation of this liability were included in other income (expense) in the consolidated statements of operations. The Note and accrued interest was fully repaid on November 26, 2009 in the amount of \$3.3 million.

On November 26, 2009, the Company issued \$10.8 million principal amount subordinated convertible promissory notes to a group of investors (the Investor Notes ) which includes related parties: Icarus (\$2,200,000), Jason DeZwirek (\$800,000), and Harvey Sandler Revocable Trust (\$800,000), which trust owns over 10% of our outstanding common stock. Interest accrues under the Investor Notes at the annual rate of 6% and is payable as of the end of each calendar quarter. Interest paid for the three and nine month periods was \$163,000 and \$485,000 respectively. We used the proceeds of the Investor Notes to repay all of our previously existing subordinated debt in the amount of approximately \$4.5 million, which debt was accruing interest at rates between 11-12%. The balance of the proceeds will be used for general working capital. Fees of \$320,000 were paid for the issuance of this debt and are being amortized over the term of the Investor Notes.

The Investor Notes are due on November 26, 2014 and are not repayable prior to maturity except upon a change of control, or upon the consent of the holder. The outstanding principal amount of the Investor Notes or any portion thereof, but not the interest, is convertible at the holder's option, at any time after the issuance of the Investor Notes at a conversion price of \$4.00 per share, such price being greater than the Company's share price at the date of issuance of the Investor Notes. Following three years from the date of the Investor Notes, if the closing price of the common stock of the Company is greater than \$8.00 for five consecutive days, the Company can cause conversion of the Investor Notes.

**Overview of Cash Flows and Liquidity**

(\$ s in thousands)	For the nine months ended September 30,	
	2010	2009
Net cash provided by continuing operations	\$ 868	\$ 10,828
Net cash provided by discontinued operations	857	2,540
Net cash provided by (used in) investing activities	1,011	(997)
Net cash provided by (used in) financing activities	56	(12,676)
Net increase (decrease) in cash and cash equivalents	\$ 2,792	\$ (305)

For the nine months ended September 30, 2010, \$0.9 million of cash was provided by continuing operating activities compared to \$10.8 million provided by continuing operating activities for the same period in 2009. The \$9.9 million decrease in cash flows from operating activities was primarily due to a net \$9.6 million decrease in cash provided by working capital changes. That net decrease was largely due to a \$13.7 million decrease in cash provided by the change in accounts receivable in the 2010 nine month period as compared to the 2009 nine month period, primarily due to lower revenues. Cash used to repay accounts payable and accrued expenses decreased from \$9.4 million in 2009 to \$3.8 million in 2010. Additionally, the 2010 nine month change in uncompleted contract balances reflects cash provided of \$1.1 million while the 2009 nine month change reflects cash provided of \$2.7 million. This decrease is primarily due to lower advance billings to customers. These working capital changes were offset by a \$2.4 million use of cash in the first nine months of 2009 to pay income taxes that was not repeated in the first nine months of 2010. The changes in working capital elements were mainly the result of continuing weak economic activity.



**Table of Contents**

**CECO ENVIRONMENTAL CORP.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**

**AND RESULTS OF OPERATIONS**

Depreciation and amortization amounted to \$1.3 million in for the nine months ended September 30, 2010 compared to \$1.9 million for depreciation and amortization in the same period in 2009. This decrease in depreciation and amortization was due to decreased amortization of definite life intangibles from recent acquisitions which are now fully amortized and decreased depreciation expense on now fully depreciated machinery and equipment. Our net investment in working capital (excluding cash and cash equivalents, current portion of debt and working capital from discontinued operations) at September 30, 2010 was \$15.5 million as compared to \$13.3 million at December 31, 2009. We believe that our working capital needs will remain constant unless we experience a significant increase or decrease in sales and operating income.

For the nine months ended September 30, 2010, net cash used in investing activities related to capital expenditures for property and equipment were \$0.4 million compared with \$1.0 million for the same period in 2009 and cash of \$1.5 million was provided by the sale of equipment related to closed facilities. We are managing our capital expenditures in light of the current level of sales.

For the nine months ended September 30, 2010, financing activities, which consisted of net borrowings from our bank, provided cash of \$56,000 compared with cash used of \$12.7 million during the same period of 2009 primarily related to net payment of debt.

When we undertake large jobs, our working capital objective is to make these projects self-funding. We try to achieve this by obtaining initial down payments, progress billing contracts, when possible, utilizing extended payment terms from material suppliers, and paying sub-contractors after payment from our customers, which is an industry practice. Our investment in net working capital is funded by cash flow from operations and by our revolving line of credit. Inventory remains relatively constant from quarter to quarter. Accordingly, changes in inventory do not constitute a significant part of our investment in working capital.

**Table of Contents**

**CECO ENVIRONMENTAL CORP.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION**

**AND RESULTS OF OPERATIONS**

Based on our historical results, management's experience, our current business strategy and current cash flows, we believe that our existing cash resources will be sufficient to meet our anticipated working capital and capital expenditure requirements for at least the next 12 months. Nevertheless, if we generate insufficient cash flows from operations or are unable to draw the amounts needed from our Bank Facility to meet our short-term liquidity needs, we may borrow additional funds. Although management believes that we will be able to fund our operations from current resources, there is no guarantee that we will be able to do so, however, alternative sources of funding are potentially available in the form of additional term debt to be provided by our lender, which may be collateralized by our real estate and equipment, as well as subordinated debt to be provided by a related party. However, we cannot provide any assurances that such financing will be available to us on favorable terms or at all.

**Forward-Looking Statements**

This Form 10-Q includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact, including statements regarding industry prospects or future results of operations or financial position made in this Form 10-Q are forward-looking. We use words such as believe, expect, anticipate, intends, estimate, forecast, project, should and similar expressions to identify forward-looking statements. Forward-looking statements are based on management's current expectations and assumptions that are subject to risks and uncertainties, many of which are beyond our control, which may cause actual results, performance or trends to differ materially from those expressed in the forward-looking statements. Potential risks, among others, that could cause actual results to differ materially are discussed under Item 1A Risk Factors of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009 and include, but are not limited to: our dependence on fixed price contracts and the risks associated therewith, including actual costs exceeding our estimates and our method of accounting for contract revenue; our history of losses and possibility of further losses; fluctuations in operating results from period to period due to seasonality of our business; the effect of growth on our infrastructure, resources, and existing sales; our ability to expand our operations in both new and existing markets; the potential for contract delay or cancellation; the potential for fluctuations in prices for manufactured components and raw materials; our ability to raise capital and the availability of capital resources; our ability to fully utilize and retain executives; the impact of federal, state or local government regulations; labor shortages or increases in labor costs; economic and political conditions generally; and the effect of competition in the air pollution control and industrial ventilation industry.

We caution investors that other factors might, in the future, prove to be important in affecting our results of operations. New factors emerge from time to time and it is not possible for management to predict all such factors, nor can it assess the impact of each such factor on the business or the extent to which any factor, or a combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Investors are further cautioned not to place undue reliance on such forward-looking statements as they speak only to our views as of the date the statement is made. Except as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether because of new information, future events or otherwise.

**Table of Contents**

**CECO ENVIRONMENTAL CORP.**

**ITEM 4T. CONTROLS AND PROCEDURES**

***Evaluation of Disclosure Controls and Procedures***

Our Chief Executive Officer and Chief Financial Officer have evaluated our disclosure controls and procedures (as such term is defined in Rules 13a- 15(e) and 15d- 15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this quarterly report. Based on this evaluation, such officers have concluded that these controls and procedures are effective as of the end of the period covered by this quarterly report on Form 10-Q in ensuring that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely discussions regarding required disclosure.

***Changes in Internal Control Over Financial Reporting***

There have been no changes in the Company s internal control over financial reporting during the quarter ended September 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

**Table of Contents**

**CECO ENVIRONMENTAL CORP.**

**PART II - OTHER INFORMATION**

**ITEM 6. EXHIBITS**

- 10.1 Amended and Restated Credit Agreement entered into August 17, 2010, effective date June 30, 2010 (Incorporated by reference from Exhibit 10.1 of the Company's Current Report on Form 8-K filed August 19, 2010).
- 10.2 Sixth Amended and Restated Revolving Credit Promissory Note, effective date June 30, 2010 (Incorporated by reference from Exhibit 10.2 of the Company's Current Report on Form 8-K filed August 19, 2010).
- 10.3 Amended and Restated Term Promissory Note, effective date June 30, 2010 (Incorporated by reference from Exhibit 10.1 of the Company's Current Report on Form 8-K filed August 19, 2010).
- 10.4 Purchase Agreement dated August 19, 2010
- 31.1 Rule 13(a)/15d-14(a) Certification by Chief Executive Officer
- 31.2 Rule 13(a)/15d-14(a) Certification by Chief Financial Officer
- 32.1 Certification of Chief Executive Officer (18 U.S. Section 1350)
- 32.2 Certification of Chief Financial Officer (18 U.S. Section 1350)



**Table of Contents**

**CECO ENVIRONMENTAL CORP.**

**SIGNATURE**

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.

CECO ENVIRONMENTAL CORP.

/s/ DENNIS W. BLAZER  
**Dennis W. Blazer**

**V.P. - Finance and Administration and Chief Financial  
Officer**

Date: November 15, 2010