

CECO ENVIRONMENTAL CORP

Form 10-Q

August 11, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED June 30, 2006

Commission File No. 0-7099

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

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Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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

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 Aug. 9, 2006 - 11,417,827

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CECO ENVIRONMENTAL CORP.

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

JUNE 30, 2006

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CONSOLIDATED BALANCE SHEETS

Dollars in thousands, except per share data

| | JUNE 30, 2006 (unaudited) | DECEMBER 31, 2005 |
|---|---------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 380 | \$ 310 |
| Accounts receivable, net | 20,947 | 13,151 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 8,850 | 4,681 |
| Inventories | 2,071 | 1,981 |
| Prepaid expenses and other current assets | 1,879 | 1,672 |
| Total current assets | 34,127 | 21,795 |
| Property and equipment, net | 8,703 | 8,796 |
| Goodwill, net | 9,527 | 9,527 |
| Intangibles finite life, net | 619 | 658 |
| Intangibles indefinite life | 1,395 | 1,395 |
| Deferred charges and other assets | 524 | 729 |
| | \$ 54,895 | \$ 42,900 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current liabilities: | | |
| Current portion of debt | \$ 620 | \$ 568 |
| Current portion of subordinated notes (related party - \$5,743 and \$0) | 5,743 | 1,000 |
| Accounts payable and accrued expenses | 13,779 | 12,017 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 8,641 | 3,766 |
| Detachable stock warrants | 535 | 842 |
| Total current liabilities | 29,318 | 18,193 |
| Other liabilities | 1,823 | 1,934 |
| Debt, less current portion | 10,057 | 6,214 |
| Deferred income tax liability | 3,143 | 3,143 |
| Subordinated notes (related party \$0 and \$6,633) | | 6,633 |
| Total liabilities | 44,341 | 36,117 |
| Shareholders equity: | | |
| Common stock, \$0.01 par value; 100,000,000 shares authorized, 11,485,747 and 10,168,479 shares issued in 2006 and 2005 | 115 | 102 |
| Capital in excess of par value | 17,828 | 15,017 |
| Accumulated deficit | (6,246) | (7,072) |
| Accumulated other comprehensive loss | (787) | (791) |
| | 10,910 | 7,256 |
| Less treasury stock, at cost, 137,920 shares in 2006 and 175,220 in 2005 | (356) | (473) |

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| | | |
|---------------------------|-----------|-----------|
| Total shareholders equity | 10,554 | 6,783 |
| | \$ 54,895 | \$ 42,900 |

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

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

Dollars in thousands, except per share data

| | THREE MONTHS ENDED | | SIX MONTHS ENDED | |
|---|--------------------|------------|------------------|-----------|
| | JUNE 30, | | JUNE 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Net sales | \$ 31,745 | \$ 20,015 | \$ 56,127 | \$ 35,070 |
| Costs and expenses: | | | | |
| Cost of sales, exclusive of items shown separately below | 26,142 | 15,747 | 46,391 | 28,629 |
| Selling and administrative | 4,070 | 2,785 | 7,215 | 5,626 |
| Depreciation and amortization | 293 | 291 | 585 | 583 |
| | 30,505 | 18,823 | 54,191 | 34,838 |
| Income from operations | 1,240 | 1,192 | 1,936 | 232 |
| Other income | 1,374 | 26 | 294 | 76 |
| Interest expense (including related party interest of \$189 and \$259, and \$421 and \$518, respectively) | (526) | (625) | (1,097) | (1,222) |
| Income (loss) from operations before income taxes | 2,088 | 593 | 1,133 | (914) |
| Income tax provision (benefit) | 526 | 358 | 307 | (517) |
| Net income (loss) | \$ 1,562 | \$ 235 | \$ 826 | \$ (397) |
| Per share data: | | | | |
| Basic net income (loss) | \$.14 | \$.02 | \$.07 | \$ (.04) |
| Diluted net income (loss) | \$.12 | \$.02 | \$.07 | \$ (.04) |
| Weighted average number of common shares outstanding: | | | | |
| Basic | 11,225,038 | 9,993,260 | 11,070,131 | 9,993,260 |
| Diluted | 12,881,584 | 10,575,497 | 12,659,750 | 9,993,260 |

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

| | SIX MONTHS ENDED | |
|---|------------------|----------|
| | JUNE 30, | |
| Dollars in thousands | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ 826 | \$ (397) |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: | | |
| Depreciation and amortization | 585 | 583 |
| Non cash interest expense included in net income | 182 | 180 |
| Non cash warrant valuation gain included in net income | (307) | |
| Non cash gains included in net loss | (29) | (40) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (7,796) | (134) |
| Inventories | (90) | (93) |
| Costs and estimated earnings in excess of billings on uncompleted contracts | (4,169) | 83 |
| Prepaid expenses and other current assets | (300) | (896) |
| Accounts payable and accrued expenses | 1,762 | (1,419) |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 4,875 | 2,265 |
| Other | 130 | 92 |
| Net cash (used in) provided by operating activities | (4,331) | 224 |
| Net cash used in investing activities - acquisition of property and equipment | (447) | (320) |
| Cash flows from financing activities: | | |
| Proceeds from exercise of warrants and options not under plan | 2,705 | |
| Proceeds from exercise of stock options | 207 | |
| Compensation expense stock options | 29 | |
| Subordinated debt repayments | (1,988) | |
| Long term debt borrowings | 3,895 | 243 |
| Net cash provided by financing activities | 4,848 | 243 |
| Net increase in cash and cash equivalents | 70 | 147 |
| Cash and cash equivalents at beginning of the period | 310 | 339 |
| Cash and cash equivalents at end of the period | \$ 380 | \$ 486 |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

| | | |
|----------------------------------|----------|--------|
| Cash paid during the period for: | | |
| Interest | \$ 2,186 | \$ 755 |
| Income taxes | \$ 166 | \$ 95 |

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

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NOTES TO 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 in accordance with accounting principles generally accepted in the United States of America. In the opinion of management, the accompanying unaudited condensed consolidated financial statements of the Company contain all adjustments (consisting only of normal recurring accruals) necessary to present fairly the financial position as of June 30, 2006 and December 31, 2005 and the results of operations for the three-month and six-month periods ended June 30, 2006 and 2005 and of cash flows for the six-month periods ended June 30, 2006 and 2005. The results of operations for the three-month period and six-month period ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year.

These financial statements should be read in conjunction with the audited financial statements and notes thereto in our 2005 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Stock Based Compensation

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, effective January 1, 2006. SFAS No. 123(R) requires public entities to measure the cost of employee services received in exchange for an award of equity instruments and recognize this cost over the period during which an employee is required to provide the services. The Company has adopted SFAS No. 123(R) using the modified prospective application as defined in the Statement, and therefore financial statements from periods ending prior to January 1, 2006 have not been restated. As a result of adopting SFAS No. 123(R) on January 1, 2006, the Company's income before income taxes for the three months and six months ended June 30, 2006 was \$14,600 and \$29,200 lower, respectively, and net income was \$9,600 and \$19,200 lower, respectively, than if it had continued to account for share-based compensation under APB No. 25. Basic and diluted earnings per share for the three months and six months ended June 30, 2006 would have been unchanged if the Company had not adopted SFAS No. 123(R). See further discussion in Note 9.

Prior to January 1, 2006, the company applied the provisions of Accounting Principles Board Opinion No. 25 (APB No. 25), Accounting for Stock Issued to Employees. Accordingly, no compensation expense was reflected in the financial statements as the exercise price of options granted to employees and non-employee directors equaled the fair market value of the Company's common shares on the date of grant. The Company had adopted the disclosure-only provisions of SFAS No. 123, Accounting for Stock Based Compensation.

If the Company had adopted the expense recognition provisions of SFAS No. 123 prior to January 1, 2006, net income and earnings per share for the three month and six month periods ended June 30, 2005 would have been as follows:

| | Three months ended | Six months ended |
|--|-----------------------|---------------------|
| <i>(In thousands except earnings per share)</i> | 06/30/05 | 06/30/05 |
| Net income (loss) as reported | \$ 235 | \$ (397) |
| Add: Stock-based compensation expense included in reported net income, net of related tax effects | | |
| Deduct: Total stock-based compensation determined under the fair value based method for all awards, net of tax effects | (8) | (16) |
| Proforma net income (loss) | \$ 227 | \$ (413) |
| Earnings per common share basic and diluted | | |
| As reported | \$ 0.02 | \$ (0.04) |

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| | | | | |
|-----------|----|------|----|--------|
| Pro forma | \$ | 0.02 | \$ | (0.04) |
|-----------|----|------|----|--------|

Certain amounts in the June 30, 2005 financial statements have been reclassified to conform to the June 30, 2006 presentation.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

2. New Accounting Standards

In July 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in tax positions. This interpretation requires the recognition in the financial statements of the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006, with the cumulative effect of the change in accounting principle recorded as an adjustment to beginning retained earnings. The Company does not expect the adoption of FIN 48 to have a material effect on its consolidated financial statements.

3. Inventories

Inventories consist of the following:

| | June 30, 2006 | December 31, 2005 |
|---------------------------------|------------------|----------------------|
| Raw materials and subassemblies | \$ 1,140 | \$ 1,107 |
| Finished goods | 250 | 160 |
| Parts for resale | 711 | 814 |
| Obsolescence allowance | (30) | (100) |
| | \$ 2,071 | \$ 1,981 |

4. Costs and Estimated Earnings on Uncompleted Contracts

| | June 30, 2006 | December 31, 2005 |
|--|------------------|----------------------|
| Costs incurred on uncompleted contracts | \$ 60,960 | \$ 34,292 |
| Estimated earnings | 7,808 | 5,547 |
| | 68,768 | 39,839 |
| Less billings to date | (68,559) | (38,924) |
| | \$ 209 | \$ 915 |
| Included in the accompanying consolidated balance sheets under the following captions: | | |
| Costs and estimated earnings in excess of billings on uncompleted contracts | \$ 8,850 | \$ 4,681 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | (8,641) | (3,766) |
| | \$ 209 | \$ 915 |

5. Business Segment Information

Our structure and operational integration results in one 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 condensed consolidated financial statements herein reflect the operating results of the segment.

6. Earnings Per Share

For the three months ended June 30, 2006 and 2005, basic weighted average common

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(unaudited)

shares outstanding were 11,225,038 and 9,993,260, respectively, while diluted average common shares outstanding were 12,881,584 and 10,575,497, respectively. For the six months ended June 30, 2006 and 2005, basic weighted average common shares outstanding were 11,070,131 and 9,993,260, respectively while diluted average common shares outstanding were 12,659,750 and 9,993,260, respectively. We consider outstanding options and warrants in computing diluted net income per share only when they are dilutive. Options and warrants to purchase 3,435,000 shares for the six months ended June 30, 2005 were not included in the computation of diluted earnings per share due to their having an anti-dilutive effect.

7. Debt

Total bank debt as of June 30, 2006 was \$10.7 million and \$6.8 million at December 31, 2005. Unused credit availability under our \$13 million revolving line of credit at June 30, 2006 was \$4.0 million. Availability is determined by a borrowing base formula contained in the credit agreement.

On December 28, 2005, Ceco Environmental Corp. (the Company) entered into a \$16.1 million credit facility (the Facility). The Facility was entered into among the Company, Ceco Group, Inc, Ceco Filters, Inc., New Busch Co., Inc., The Kirk & Blum Manufacturing Company, Kbd/Technic, Inc., CecoAire, Inc, Ceco Abatement Systems, Inc. (all of which are direct or indirect subsidiaries of the Company and collectively with the Company, the Borrowers) and Fifth Third Bank, an Ohio banking corporation (Fifth Third).

On June 8, 2006, the Borrowers amended the Facility pursuant to a First Amendment to Credit Agreement (Amendment), an Amended and Restated Revolving Credit Promissory Note (Revolving Note), an Amended and Restated Term Promissory Note (Term Note), and a Joinder Agreement, all dated as of June 8, 2006. H.M. White, Inc., a wholly owned subsidiary of CECO Group, Inc., was added as a Borrower. In connection with the amendments to the Facility, the personal guaranty of Phillip DeZwirek was released pursuant to a Release of Guaranty dated June 8, 2006 (Release). The Amendment amended the Facility by, among other things (i) extending the maturity date of the Credit Agreement from January 31, 2007 to January 31, 2009, (ii) lowering the interest rate on the revolving loan and term loan from the prime rate plus 2.25% and the prime rate plus 2.0%, respectively, to either prime plus 0.5% or LIBOR plus 2.75%, at the option of the Borrowers, and (iii) establishing an incentive pricing grid pegged to performance.

8. 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 | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | June 30, 2006 | June 30, 2005 | June 30, 2006 | June 30, 2005 |
| Retirement plan: | | | | |
| Service cost | \$ 32 | \$ 33 | \$ 64 | \$ 66 |
| Interest cost | 71 | 69 | 142 | 138 |
| Expected return on plan assets | (84) | (76) | (168) | (152) |
| Amortization of prior service cost | 2 | 2 | 4 | 4 |
| Amortization of net actuarial (gain)/loss | 23 | 22 | 46 | 44 |

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| | | | | |
|---------------------------|-------|-------|-------|--------|
| Net periodic benefit cost | \$ 44 | \$ 50 | \$ 88 | \$ 100 |
| Health care plan: | | | | |
| Interest cost | \$ 6 | \$ 7 | \$ 12 | \$ 14 |

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CECO ENVIRONMENTAL CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

We previously disclosed in our financial statements for the year ended December 31, 2005 that we expected to make \$483,000 in contributions to the Pension Plan during the year ending December 31, 2006. As of June 30, 2006, \$199,000 has been contributed to the Pension Plan and we plan on making the balance of \$284,000 during the remainder of Fiscal Year 2006.

9. Equity compensation

On January 1, 2006, the Company adopted SFAS No. 123(R), Share-Based Payment, which requires the Company to measure the cost of employee services received in exchange for an award of equity instruments and to recognize this cost in the financial statements over the period during which an employee is required to provide services. The Company has adopted SFAS No. 123(R) using the modified prospective application as defined in the Statement, and therefore financial statements for periods ending prior to January 1, 2006 have not been restated. Prior to January 1, 2006, the Company had applied provisions of Accounting Principles Board Opinion No. 25, (Accounting for Stock Issued to Employees) and booked no compensation expense in the financial statements. The Company adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123 (SFAS No. 123), Accounting for Stock Based Compensation.

Stock Options

The Company has an equity compensation plan that was approved by shareholders which covers all of its full-time employees, outside directors and advisors. The options granted or stock awards made pursuant to this plan are granted at fair market value or greater at date of grant or award and are issued as new shares by the company's transfer agent. Options granted to non-employee directors typically vest at 5,000 shares per year and options granted to employees typically become exercisable at 20% or 25% per year beginning one year after the date of grant. The Stock Option Committee may, at its discretion, establish other vesting periods when appropriate. The number of shares reserved for issuance is 1.5 million, of which 1.1 million shares were available for future grant or award as of June 30, 2006. This plan allows for the grant of incentive stock options and non-qualified stock options. As of June 30, 2006, a total of 297,500 options for common shares were outstanding and of these, a total of 105,000 options for common shares were vested and exercisable.

SFAS No. 123 was effective for the Company through December 31, 2005 and required, at a minimum, pro forma disclosures of expense for stock-based awards based on their fair values. See Note 1 for this information. The fair value of each option on the date of grant was estimated using the Black-Scholes option pricing model.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

SFAS No. 123(R) requires stock option expense to be recorded on the financial statements for all reporting periods beginning after January 1, 2006. Accordingly, an expense of \$14,600 was recorded in each of the first two quarters of fiscal 2006. No similar expense was recorded in fiscal 2005. No equity compensation expense has been capitalized in inventory or fixed assets.

Awards granted prior to January 1, 2006:

Prior to January 1, 2006, the Company applied the provisions of APB No. 25 and no compensation expense was recorded in the financial statements. The Company had adopted the disclosure-only provisions of SFAS 123, Accounting for Stock-Based Compensation.

Compensation cost for the outstanding stock options as of January 1, 2006, for which the requisite service has not been rendered, will be recognized over their remaining vesting periods. The compensation cost for these outstanding options will be based upon their originally calculated fair values as used in pro forma disclosures under SFAS 123, except that the Company will discontinue its previous method of recognizing forfeitures only as they occur. As of January 1, 2006, the Company has estimated the number of these outstanding options which will be forfeited prior to vesting and has accordingly adjusted compensation expense for these options going forward.

As no compensation expense has previously been recorded in the Company's financial statements for these outstanding options, no cumulative effect of a change in accounting principle is required as of January 1, 2006.

Awards granted after adoption of SFAS 123(R):

For awards granted during the six months ended June 30, 2006, the Company utilized the Black-Scholes option pricing model to determine grant-date fair value, using the following assumptions:

Expected Volatility of 60% was used based upon the historical volatility of the Company's stock price for a period of time commensurate with the expected terms of the options. The frequency of price observations was based on weekly values.

The Expected Terms of 6.5 years for options that vest in 3 years and 7.5 years for options that vest in 5 years for plain vanilla options granted during the three months ended June 30, 2006 were calculated using the simplified method as permitted under the guidelines of SAB 107.

The Risk-Free Interest Rates of 5.16% for options that vest in 3 years and 5.19% for options that vest in 5 years were based upon the implied yields currently available on U.S. Treasury zero-coupon issues with a remaining term equal to the Expected Term.

No assumptions were made for Expected Dividends as the Company has not historically paid dividends. This will be re-evaluated if and when dividends are expected to be paid.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The fair value of the granted options is recorded as compensation expense on a straight-line basis over the vesting period of the option. The amount of compensation cost recognized at any date (for graded-vesting options) is at least equal to the portion of the grant-date value of the award that is vested at that date. As required under SFAS 123(R), the Company estimated that 7.0 % of the options granted in the six months ended June 30, 2006 will be forfeited and has adjusted compensation expense accordingly. This estimate will be reviewed periodically and updated as necessary.

Information related to all stock options for the six months ended June 30, 2006 is shown in the table below:

| <i>(Shares in thousands)</i> | Shares | Weighted average exercise price | Weighted Average Remaining Contractual term | Aggregate Intrinsic Value (\$000) |
|------------------------------|--------|---------------------------------|---|-----------------------------------|
| Outstanding at 12/31/05 | 264 | \$ 2.64 | | |
| Granted | | | | |
| Forfeitures | | | | |
| Exercised | (46) | 2.93 | | |
| Outstanding at 3/31/06 | 218 | \$ 2.58 | 7.5 years | \$ 1,343 |
| Granted | 120 | 7.31 | | |
| Forfeitures | | | | |
| Exercised | (40) | 2.88 | | |
| Outstanding at 6/30/06 | 298 | \$ 4.38 | 8.5 years | \$ 1,076 |
| Exercisable at 6/30/06 | 105 | \$ 2.13 | 6.8 years | \$ 617 |

The Company received \$114,000 of cash from employees who exercised 40,000 options during the three months ended June 30, 2006 and \$251,000 for 86,000 options exercised in the six months ended June 30, 2006. The intrinsic value of these exercised options totaled \$210,000 and \$282,000 for the three months ended March 31, 2006 and June 30, 2006 respectively. The Company also received \$1.8 million of cash from 1.0 million warrants exercised by the DeZwirek family during the six months ended June 30, 2006 as previously reported in the first quarter. The intrinsic value of these warrants totaled \$4.6 million. The company has a net operating loss carryforward and, as a result, the tax benefit and credit to additional paid-in capital for the excess deduction will not be recognized until that future deduction reduces current taxes payable.

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(unaudited)

ITEM 2. Results of Operations

Our condensed consolidated statements of operations for the three-month and six-month periods ended June 30, 2006 and 2005 reflect our operations consolidated with the operations of our subsidiaries.

| (\$ s in millions) | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------------------|--------------------------------|---------|------------------------------|---------|
| | 2006 | 2005 | 2006 | 2005 |
| Sales | \$ 31.7 | \$ 20.0 | \$ 56.1 | \$ 35.1 |
| Cost of sales | 26.1 | 15.7 | 46.4 | 28.7 |
| Gross profit (excluding depreciation) | \$ 5.6 | \$ 4.3 | \$ 9.7 | \$ 6.4 |
| Percent of sales | 17.7% | 21.3% | 17.3% | 18.4% |
| Selling and administrative expenses | \$ 4.1 | \$ 2.8 | \$ 7.2 | \$ 5.6 |
| Percent of sales | 12.8% | 13.9% | 12.9% | 16.0% |
| Operating income | \$ 1.2 | \$ 1.2 | \$ 1.9 | \$.2 |
| Percent of sales | 3.9% | 6.0% | 3.4% | .7% |

Consolidated net sales for the second quarter increased 58.6% or \$11.7 million to \$31.7 million, compared to the same quarter in 2005.

Consolidated net sales for the first six months of 2006 were \$56.1 million an increase of \$21.0 million or 60.0% compared to the same period in 2005. Sales of our duct product lines, which are sold to contractors and end-users throughout North America, experienced significant increases during the second quarter and first six months. Sales of our contracting group also experienced significant increases during the second quarter and first six months due to the addition of H.M. White and increased project volume and activity within the other contracting divisions. Equipment group sales were lower for the second quarter but still remain higher for the six months ended June 30, 2006.

Orders booked were \$34.9 million during the second quarter of 2006 and \$70.9 million for the first six months of 2006, as compared to \$23.6 million during the second quarter of 2005 and \$40.7 million in the first half of 2005.

Second quarter 2006 gross profit was \$5.6 million. This compares to gross profit of \$4.3 million during the same period in 2005. Gross profit as a percentage of revenues for the three-month period ended June 30, 2006 decreased 3.6% to 17.7% compared with 21.3% for the comparable period in 2005. This decrease was due to lower margins in our contracting and equipment group partially offset by higher margins in our parts group.

Gross profit was \$9.7 million for the first six months of 2006, an increase of \$3.3 million compared to \$6.4 million for the same period in 2005. Gross profit as a percentage of revenues for the first six months of 2006 decreased 1.1% to 17.3% compared with 18.4% for the comparable period in 2005.

Selling and administrative expenses increased by \$1.3 million from \$2.8 million to \$4.1 million during the second quarter and increased by \$1.6 million or 28.2% from \$5.6 million to \$7.2 million during the first six months of 2006 compared to 2005. This increase is due primarily to the addition of administrative costs from our new H.M. White division coupled with increases in selling and administrative wages and incentive compensation. Selling and administrative expense as a percentage of sales decreased from 13.9% to 12.8% for the quarter ended June 30, 2006 and decreased from 16.0% to 12.9% for the six months ended June 30, 2006.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

(unaudited)

Depreciation and amortization increased by \$2,000 to \$293,000 during the second quarter of 2006 from \$291,000 in the same period of 2005 and increased by \$2,000 to \$585,000 in the first six months of 2006 from \$583,000 in the same period of 2005.

Operating income was \$1.2 million in the second quarter of 2006 compared to operating income of \$1.2 million during the same quarter of 2005. Operating income for the first six months of 2006 was \$1.9 million compared to an operating income of \$232,000 during the same period of 2005. The impact from higher sales, partially offset by reduced gross profit margin percentages and increased selling and administrative costs were the primary factors for the increases in operating income.

Other income was \$1.4 million in the second quarter of 2006 compared to \$26,000 in the second quarter of 2005. \$1.3 million of this second quarter 2006 income was the result of the exercise of 248,000 warrants issued in December 2001 plus \$96,000 of income created by a slight decrease in the company's stock price which reduced the carrying value of the remaining 119,000 warrants issued in December 2001.

Other income for the first six months of 2006 was \$294,000 compared to \$76,000 during the same period in 2005. The other income during the first six months of 2006 reflects the net of the first quarter expense for the revaluation of warrants of \$1.1 million and the second quarter income of \$1.3 million created by the exercise of warrants and the revaluation of the remaining warrants in the second quarter as previously mentioned.

Interest expense decreased by \$99,000 from \$625,000 in the second quarter of 2005 to \$526,000 during the second quarter of 2006. Interest expense decreased by \$125,000 to \$1.1 million from \$1.2 million during the first six months of 2006. The decrease for the quarter and six months ended June 30, 2006 was due to lower interest charges from the reduced subordinated debt and lower interest rates on the amended credit line partially offset by higher borrowings.

Federal and state income tax provision was \$526,000 during the second quarter of 2006 compared to \$358,000 during the second quarter of 2005. Federal and state income tax expense was \$307,000 for the first six months of 2006 compared to a tax benefit of \$517,000 in 2005. The federal and state income tax provision for the first six months of 2006 was 27%, which reflects the estimated effective tax rate for 2006. Our statutory income tax rate is affected by certain permanent differences including income or expense for market valuation of warrants and non-deductible interest expense.

Net Income for the quarter ended June 30, 2006 was \$1.6 million compared with net income of \$235,000 for the same period in 2005. Net income for the six months ended June 30, 2006 was \$826,000 compared with a net loss of \$397,000 for the same period in 2005.

Backlog

Our backlog consists of orders we have received for products and services we expect to ship and deliver within the next 12 months. Our backlog, as of June 30, 2006 was \$43.7 million compared to \$28.9 million as of December 31, 2005. There can be no assurances that backlog will be replicated, increased or translated into higher revenues in the future. 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 project, weather, and labor availability also can have an effect on a contract's profitability.

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Financial Condition, Liquidity and Capital Resources

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

At June 30, 2006 and December 31, 2005, cash and cash equivalents totaled \$380,000 and \$310,000 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.

Total bank debt as of June 30, 2006 was \$10.7 million and \$6.8 million at December 31, 2005. Unused credit availability under our \$13 million revolving line of credit at June 30, 2006 was \$4.0 million. Availability is determined by a borrowing base formula contained in the credit agreement.

On December 28, 2005, the Company entered into a \$16.1 million credit facility (the Facility). The Facility was entered into among the Company, Ceco Group, Inc, Ceco Filters, Inc., New Busch Co., Inc., The Kirk & Blum Manufacturing Company (K&B), Kbd/Technic, Inc., CecoAire, Inc, Ceco Abatement Systems, Inc. (all of which are direct or indirect subsidiaries of the Company and collectively with the Company, the Borrowers) and Fifth Third Bank, an Ohio banking corporation (Fifth Third). On June 8, 2006, the Borrowers amended the Facility pursuant to a First Amendment to Credit Agreement (Amendment), an Amended and Restated Revolving Credit Promissory Note (Revolving Note), an Amended and Restated Term Promissory Note (Term Note), and a Joinder Agreement, all dated as of June 8, 2006. H.M. White, Inc., a wholly owned subsidiary of CECO Group, Inc., was added as a Borrower. In connection with the amendments to the Facility, the personal guaranty of Phillip DeZwirek was released pursuant to a Release of Guaranty dated June 8, 2006 (Release). The Amendment amended the Facility by, among other things (i) extending the maturity date of the Credit Agreement from January 31, 2007 to January 31, 2009, (ii) lowering the interest rate on the revolving loan and term loan from the prime rate plus 2.25% and the prime rate plus 2.0%, respectively, to either prime plus 0.5% or LIBOR plus 2.75%, at the option of the Borrowers, and (iii) establishing an incentive pricing grid pegged to performance.

On June 20, 2005, K&B, an indirectly wholly owned subsidiary of the Company, entered into a Restated and Amended Purchase Agreement with Trademark Property Company (Trademark) for the sale of the Cincinnati manufacturing and corporate office facilities (the Agreement). Subsequently, pursuant to a Third Amendment and Assignment to the Agreement, dated as of October 20, 2005 and disclosed on an 8-K filed October 26, 2005, Trademark assigned the Agreement to Millworks Town Center, LLC (Purchaser). Pursuant to a Fourth Amendment and Assignment to Restated and Amended Purchase Agreement, a Fifth Amendment to Restated and Amended Purchase Agreement, a Sixth Amendment to Restated and Amended Purchase Agreement, and a Seventh Amendment to Restated and Amended Purchase Agreement (Seventh Amendment), the closing of Parcel A was extended. An Eighth Amendment extended the date by which the extension fee could be paid. Pursuant to a Ninth Amendment to Restated and Amended Purchase Agreement (Ninth Amendment) between Purchaser and K&B, dated June 8, 2006, the closing of Parcel A has been extended until August 31, 2006. K&B waived the extension fee set forth in the Seventh Amendment. Under the Ninth Amendment, Purchaser may extend the closing of Parcel A until on or before November 30, 2006, by delivering to K&B a nonrefundable, but fully applicable to the purchase price, payment of Four Hundred Fifty Thousand Dollars (\$450,000.00) on or before August 31, 2006. The closing of the acquisition is subject to various customary closing conditions. Additionally, closing is subject to certain special conditions such as the negotiation of a definitive agreement setting forth K&B's post-closing possessory rights.

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(unaudited)

Overview of Cash Flows and Liquidity

| (\$ s in thousands) | For the six months | |
|---|--------------------|--------|
| | ended June 30, | |
| | 2006 | 2005 |
| Net cash (used in) provided by operating activities | \$ (4,331) | \$ 224 |
| Net cash (used) in investing activities | (447) | (320) |
| Net cash provided by financing activities | 4,848 | 243 |
| Net increase | \$ 70 | \$ 147 |

Cash used in operating activities was \$4.3 million in 2006 compared to cash provided by operating activities in 2005 of \$224,000. Cash used in operating activities for the first six months of 2006 was the result of an increase of \$7.8 million in accounts receivable and an increase in costs and earnings in excess of billings of \$4.2 million partially offset by cash provided by an increase in billings in excess of costs and estimated earnings of \$4.9 million, an increase in accounts payable of \$1.8 million and net income of \$826,000. Other changes in working capital items used cash of \$200,000. Our net investment in working capital (excluding cash and cash equivalents and current portion of debt) at June 30, 2006 and December 31, 2005 was \$10.8 million and \$4.9 million, respectively. The large increase in working capital is due to significantly higher sales in 2006. We anticipate that sales will remain constant at this higher level and that billings in excess of cost and estimated earnings, which represent advanced customer billings and which are also included in accounts receivable, will provide future cash as these invoices are paid by our customers.

Net cash used in investing activities related to the acquisition of capital expenditures for property and equipment was \$447,000 for the first six months of 2006 compared with \$320,000 for the same period in 2005. We are managing our capital expenditure spending in light of the current level of sales. Should sales continue to increase in 2006, we would anticipate increased capital spending. Additionally, capital expenditures may be incurred depending on the ultimate disposition of our Cincinnati property.

Financing activities provided cash of \$4.8 million during the first six months of 2006 compared with cash provided by financing activities of \$243,000 during the same period of 2005. Approximately \$3.9 million was provided by borrowing against the line of credit and \$2.9 million was provided by the exercise of warrants and options. \$2.0 million of cash was used to reduce the subordinated debt.

Forward-Looking Statements

We desire to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and are making this cautionary statement in connection with such safe harbor legislation. This Form 10-Q, the Annual Report to Shareholders, Form 10-K or Form 8-K of the Company or any other written or oral statements made by or on our behalf may include forward-looking statements, which reflect our current views with respect to future events and financial performance. The words believe, expect, anticipate, intends, estimate, forecast, project, and similar expressions are intended to identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All forecasts and projections in this Form 10-Q are forward-looking statements, and are based on management's current expectations of our near-term results, based on current information available pertaining to us.

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(unaudited)

We wish to caution investors that any forward-looking statements made by or on our behalf are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. These uncertainties and other risk factors include, but are not limited to: changing economic and political conditions in the United States and in other countries, war, changes in governmental spending and budgetary policies, governmental laws and regulations surrounding various matters such as environmental remediation, contract pricing, and international trading restrictions, customer product acceptance, continued access to capital markets, and foreign currency risks.

We wish to 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. We undertake no obligation to publicly update or revise any forward-looking statements, whether because of new information, future events or otherwise.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Risk Management Activities

In the normal course of business, we are exposed to market risk including changes in interest and raw material commodity prices. We may use derivative instruments to manage our interest rate exposures. We do not use derivative instruments for speculative or trading purposes. Generally, we enter into hedging relationships such that changes in the fair values of cash flows of items and transactions being hedged are expected to be offset by corresponding changes in the values of the derivatives.

Interest Rate Management

We may use interest rate swap contracts to adjust the proportion of our total debt that is subject to variable interest rates. Our interest rate swap contract matured in 2002 and was not renewed.

The remaining amount of loans outstanding under the Credit Agreement bear interest at the floating rates as described in Note 9 to the consolidated statements contained in the Company's 2005 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Credit Risk

As part of our ongoing control procedures, we monitor concentrations of credit risk associated with financial institutions with which we conduct business. Credit risk is minimal as credit exposure is limited with any single high quality financial institution to avoid concentration. We also monitor the creditworthiness of our customers to which we grant credit terms in the normal course of business. Concentrations of credit associated with these trade receivables are considered minimal due to our geographically diverse customer base. Bad debts have not been significant. We do not normally require collateral or other security to support credit sales.

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CECO ENVIRONMENTAL CORP.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e)) under the Securities and Exchange Act of 1934 (the Exchange Act) designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the specified time periods. Our Chief Executive Officer and Chief Financial Officer evaluated, with the participation of our management, the effectiveness of our disclosure controls and procedures as of June 30, 2006. Based on the evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. There were no significant changes in our disclosure controls or in other factors that could significantly affect our disclosure controls and procedures subsequent to the evaluation.

Internal Controls Over Financial Reporting

We are not subject to the disclosure requirements promulgated under Section 404 of the Sarbanes-Oxley Act of 2002 regarding internal controls over financial reporting until we file our Annual Report on Form 10-K for the year ended December 31, 2007. There were no significant changes in our internal controls over financial reporting that occurred during our most recent fiscal quarter that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**CECO ENVIRONMENTAL CORP.****PART II -OTHER INFORMATION****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

As previously reported, the Company issued on December 31, 2001 warrants (Warrants) to purchase 353,334 shares of our common stock to a group of accredited investors and 14,000 shares of our common stock as a finder s fee, at an initial exercise price of \$3.60 per share. The Warrants have a five-year term. Holders of such Warrants, on June 14, 2006, exercised their Warrants to purchase 6,300 shares of our common stock and the Company has issued said 6,300 shares (the Warrant Shares). The Company received \$22,680 of proceeds from the exercise of such Warrants, which proceeds were used as working capital. The Warrant Shares issued were exempt from registration under Section 4(2) of the Securities Act of 1933, as amended. The Warrant Shares have been registered for resale on Form S-3 (File No. 333-130294),

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

At its Annual Meeting on May 24, 2006, the shareholders of CECO Environmental Corp. took the following actions:

1. Elected the following seven directors for terms to expire at the 2007 Annual Meeting of Shareholders, with votes as indicated opposite each director s name:

| Nominees: | Votes for | Votes Withheld | % Votes For |
|--------------------|------------------|-----------------------|--------------------|
| Richard J. Blum | 9,913,523 | 31,840 | 88.45 |
| Arthur Cape | 9,913,563 | 31,800 | 88.45 |
| Jason DeZwirek | 9,912,263 | 33,100 | 88.44 |
| Phillip DeZwirek | 9,913,563 | 31,800 | 88.45 |
| Thomas J. Flaherty | 9,913,503 | 31,860 | 88.45 |
| Ronald E. Krieg | 9,913,063 | 32,300 | 88.45 |
| Donald A. Wright | 9,913,463 | 31,900 | 88.45 |

2. Shareholders ratified the appointment of Battelle and Battelle, LLP as the Company s independent auditors for the fiscal year ending December 31, 2006 as follows:

| | |
|---------------|-----------|
| Votes For | 9,939,013 |
| Votes against | 4,800 |
| Abstain | 1,550 |
| %Votes For | 88.68% |

ITEM 6. EXHIBITS

10.1 Sixth Amendment to Restated and Amended Purchase Agreement between The Kirk & Blum Manufacturing Company and Millworks Town Center LLC for the sale of the Cincinnati manufacturing and corporate office facilities dated April 21, 2006. (Incorporated by reference from the Company s Form 8-K dated April 21, 2006)

10.2 Seventh Amendment to Restated and Amended Purchase Agreement between The Kirk & Blum Manufacturing Company and Millworks Town Center LLC for the sale of the Cincinnati manufacturing and corporate office facilities dated May 9, 2006. (Incorporated by reference from the Company s Form 8-K dated May 9, 2006)

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10.3 2006 Executive Incentive Compensation Plan, Eligible Participants and Performance Targets 2006 dated May 24, 2006. (Incorporated by reference from the Company's Form 8-K dated May 24, 2006)

10.4 Employment Agreement, dated as of May 30, 2006, between Richard J. Blum and CECO Group, Inc. (Incorporated by reference from the Company's Form 8-K dated May 30, 2006)

10.5 Letter agreement dated May 30, 2006 with Fifth Third Bank permitting payment of principal and interest on the ICS and Sandler Subordinated Debt. (Incorporated by reference from the Company's Form 8-K dated May 30, 2006)

10.6 Employment Agreement, dated as of June 12, 2006, between David A. Blum and CECO Group, Inc. (Incorporated by reference from the Company's Form 8-K dated June 12, 2006)

10.7 First Amendment to Credit Agreement dated June 8, 2006. (Incorporated by reference from the Company's Form 8-K dated June 8, 2006)

10.8 Amended and Restated Revolving Credit Promissory Note dated June 8, 2006. (Incorporated by reference from the Company's Form 8-K dated June 8, 2006)

10.9 Amended and Restated Term Promissory Note dated June 8, 2006. (Incorporated by reference from the Company's Form 8-K dated June 8, 2006)

10.10 Release of Guaranty dated June 8, 2006. (Incorporated by reference from the Company's Form 8-K dated June 8, 2006)

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)

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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: August 11, 2006