

CECO ENVIRONMENTAL CORP

Form 10-Q

August 11, 2008

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**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 June 30, 2008

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)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

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

**3120 Forrer Street, Cincinnati, Ohio 45209**  
(Address of principal executive offices) (Zip Code)

**513-458-2600**  
(Registrant's telephone number, including area code)

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 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).

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 August 4, 2008 14,949,352

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CECO ENVIRONMENTAL CORP.

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

JUNE 30, 2008

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## CONSOLIDATED BALANCE SHEETS

Dollars in thousands, except per share data

	JUNE 30, 2008 (unaudited)	DECEMBER 31, 2007
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 863	\$ 656
Accounts receivable, net	40,712	47,736
Costs and estimated earnings in excess of billings on uncompleted contracts	15,905	11,541
Inventories	6,376	4,694
Prepaid expenses and other current assets	3,256	2,907
Total current assets	67,112	67,534
Property and equipment, net	11,601	9,284
Goodwill, net	26,791	14,761
Intangibles - finite life, net	2,508	1,480
Intangibles - indefinite life	2,895	2,095
Deferred charges and other assets	1,378	1,381
	\$ 112,285	\$ 96,535
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of debt	\$ 1,000	\$ 278
Accounts payable and accrued expenses	32,516	38,012
Billings in excess of costs and estimated earnings on uncompleted contracts	12,255	8,024
Total current liabilities	45,771	46,314
Other liabilities	2,102	2,178
Debt, less current portion	18,835	4,429
Deferred income tax liability	2,688	2,688
Total liabilities	69,396	55,609
Shareholders' equity:		
Common stock, \$0.01 par value; 100,000,000 shares authorized, 15,087,272 and 14,927,292 shares issued in 2008 and 2007, respectively	150	149
Capital in excess of par value	42,293	40,796
Accumulated earnings	2,128	1,674
Accumulated other comprehensive loss	(1,326)	(1,337)
	43,245	41,282
Less treasury stock, at cost, 137,920 shares in 2008 and 2007	(356)	(356)

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Total shareholders' equity	42,889	40,926
	\$ 112,285	\$ 96,535

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

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## CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

Dollars in thousands, except per share data

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	JUNE 30,		JUNE 30,	
	2008	2007	2008	2007
Net sales	\$ 57,446	\$ 59,247	\$ 104,308	\$ 102,710
Costs and expenses:				
Cost of sales, exclusive of items shown separately below	46,616	49,336	86,836	84,962
Selling and administrative	7,977	6,204	14,763	11,221
Depreciation and amortization	795	400	1,386	726
	55,388	55,940	102,985	96,909
Income from operations	2,058	3,307	1,323	5,801
Other income		6		9
Interest expense (including related party interest of \$0 and \$864, and \$0 and \$1,101, respectively)	(370)	(1,160)	(579)	(1,718)
Income from continuing operations before income taxes	1,688	2,153	744	4,092
Income tax provision	659	1,006	290	1,801
Net income	\$ 1,029	\$ 1,147	\$ 454	\$ 2,291
Per share data:				
Basic net income	\$ 0.07	\$ 0.09	\$ 0.03	\$ 0.19
Diluted net income	\$ 0.07	\$ 0.08	\$ 0.03	\$ 0.18
Weighted average number of common shares outstanding:				
Basic	14,780,369	13,000,124	14,735,290	12,251,694
Diluted	15,207,924	13,577,836	15,186,105	12,848,505

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



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## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

Dollars in thousands

	SIX MONTHS ENDED JUNE 30,	
	2008	2007
Cash flows from operating activities:		
Net income	\$ 454	\$ 2,291
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,386	726
Non cash interest expense included in net income	31	865
Compensation expense stock awards	558	144
Deferred income taxes		337
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable	11,627	(1,618)
Inventories	(1,086)	(1,724)
Costs and estimated earnings in excess of billings on uncompleted contracts	(2,824)	(3,625)
Prepaid expenses and other current assets	(11)	278
Deferred charges and other assets	(101)	72
Accounts payable and accrued expenses	(10,197)	8,622
Billings in excess of costs and estimated earnings on uncompleted contracts	1,910	(2,672)
Accrued income taxes		(284)
Other	(90)	52
Net cash provided by operating activities	1,657	3,464
Cash flows from investing activities:		
Acquisition of property and equipment	(1,274)	(583)
Net cash paid for acquisition	(15,347)	(6,955)
Net cash used in investing activities	(16,621)	(7,538)
Cash flows from financing activities:		
Net borrowings (repayments) on revolving credit line	10,378	(8,967)
Proceeds from secondary stock offering		14,168
Proceeds from exercise of warrants & options not under plan		4,687
Proceeds from exercise of stock options	43	70
Subordinated debt repayments		(5,743)
Term debt borrowings	5,000	
Term debt repayments	(250)	
Net cash provided by financing activities	15,171	4,215



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Net increase in cash and cash equivalents	207	141
Cash and cash equivalents at beginning of the period	656	445
Cash and cash equivalents at end of the period	\$ 863	\$ 586
Supplemental Schedule of Non-Cash Activities:		
Stock based consideration for acquisition	\$ 898	\$

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SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION

Cash paid during the period for:		
Interest	\$ 582	\$ 1,035
Income taxes	\$ 447	\$ 2,850

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

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CECO ENVIRONMENTAL CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

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

The accompanying unaudited 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 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, 2008 and December 31, 2007 and the results of operations for the three-month and six-month periods ended June 30, 2008 and 2007 and of cash flows for the six-month periods ended June 30, 2008 and 2007. The results of operations for the three-month period and six-month period ended June 30, 2008 are not necessarily indicative of the results to be expected for the full year. The balance sheet as of December 31, 2007 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, 2007.

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 filed for the fiscal year ended December 31, 2007 with the Securities and Exchange Commission

**2. New Accounting Pronouncements**

Effective January 1, 2008, the Company adopted Financial Accounting Standards Board (FASB) Statement No. 157, Fair Value Measurements (SFAS 157). SFAS 157 applies to most current accounting pronouncements that require or permit fair value measurements. SFAS 157 provides a framework for measuring fair value and requires expanded disclosures about fair value methods and inputs by establishing a hierarchy for ranking the quality and reliability of the information used by management to measure and report amounts at fair value.

The Company has only partially applied the provisions of SFAS 157 as management has elected the deferral provisions of FASB Staff Position (FSP) SFAS 157-2 as it applies to nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The major categories of assets and liabilities that are recognized or disclosed at fair value on a nonrecurring basis include certain amounts of property and equipment and goodwill reported at fair value as a result of impairment testing, and certain other assets, liabilities and equity instruments recognized as a result of prior business combinations.

The Company does not have any financial instruments that required a cumulative-effect adjustment to beginning accumulated earnings upon adoption. There was no material impact to the Company's consolidated financial position, results of operations, or cash flows as a result of the adoption of SFAS 157.

*Financial instruments and fair value measurements*

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company utilizes certain assumptions that market participants would use in pricing assets and liabilities, including assumptions about risk. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company attempts to utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the inputs used in the valuation techniques,



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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

the Company classifies the inputs under a fair value hierarchy that ranks the inputs based on their quality and reliability. Financial instruments carried at fair value will be classified and disclosed in one of the following three categories:

**Level 1** Quoted market prices in active markets for identical assets or liabilities

**Level 2** Observable market based inputs or unobservable inputs that are corroborated by market data.

**Level 3** Unobservable inputs that are not corroborated by market data.

The Company's financial instruments consist primarily of cash and cash equivalents, receivables and certain other assets, such as cash surrender life insurance, as well as obligations under accounts payable and long-term debt. The estimated fair values of the Company's short-term financial instruments, including cash and cash equivalents, receivables and payables arising in the ordinary course of business and certain other assets, such as cash surrender life insurance approximate their individual carrying amounts due to the relatively short period of time between their origination and expected realization. The carrying amount of long-term debt approximates fair value because the interest rates fluctuate with market interest rates. The Company does not have any other financial instruments measured at fair value on a recurring basis that require further disclosure.

Financial instruments that potentially subject the Company to a concentration of credit risk principally consist of cash and cash equivalents and trade accounts receivable. Cash and cash equivalents are placed with high-credit quality financial institutions and the Company does not believe that there is a significant concentration of credit risk associated with cash and cash equivalents. The Company believes that its credit risk associated with trade accounts receivable is limited based on the reputation of their customers, historical collection experience, and industry and geographic diversification of their customers. Credit limits, ongoing credit evaluation, and account monitoring procedures are utilized by management to minimize the risk of loss. The Company maintains an allowance to cover estimated credit losses.

**SFAS 159** In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. This Statement provides companies with an option to report selected financial assets and liabilities at fair value in an effort to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 requires entities to display the fair value of those assets and liabilities for which the entity has chosen to use fair value on the face of the balance sheet. The standard is effective for the Company as of January 1, 2008; however, the Company did not elect the fair value option for any eligible items.

**SFAS 141(R)** In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*. This Statement defines the acquirer in a business combination as the entity that obtains control of one or more businesses, and establishes the acquisition date as the date the acquirer achieves this control. This Statement also refines the application of the purchase method by requiring the acquirer to recognize assets acquired and liabilities assumed at fair value and replacing the cost-allocation process previously required under SFAS 141. Included in fair value are contractual contingencies to the extent that it is more likely than not that such contingencies meet the definition of assets or liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*. The carrying value of such contractual contingencies remains unchanged until settled or until new information is obtained indicating the value of an asset is lower than acquisition-date fair value or that a liability is higher than acquisition-date fair value. Furthermore, acquisition-related costs and restructuring costs that are expected but not



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

obligatory are required to be recognized separately from the business combination. SFAS 141(R) will be effective prospectively for business combinations with acquisition dates on or after January 1, 2009. Management believes this Statement could have a material impact on the Company's financial statements depending on future acquisition plans.

EITF No. 06-11 In March 2007, the FASB ratified Emerging Issues Task Force (EITF) No. 06-11, Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards. EITF 06-11 requires companies to recognize the income tax benefit realized from dividends or dividend equivalents that are charged to retained earnings and paid to employees for nonvested equity-classified employee share-based awards as an increase to additional paid-in capital instead of a credit to income tax expense. Then amount recognized in additional paid-in capital will be available to absorb potential future tax deficiencies on share based payment awards. EITF 06-11 is effective for fiscal years beginning after December 15, 2007 and therefore is effective for the Company in fiscal year 2008. The adoption of this standard did not have a material effect on the Company's consolidated results of operations, financial position or cash flows.

SFAS 162 In May 2008, the FASB issued SFAS 162, The Hierarchy of Generally Accepted Accounting Principles. This statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States. This statement will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board (PCAOB) amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. We do not expect the adoption of this statement will have a material impact on our financial statements.

**3. Inventories**

\$ in thousands

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
Raw materials and subassemblies	\$ 4,437	\$ 3,625
Finished goods	1,052	293
Parts for resale	986	786
Obsolescence allowance	(99)	(10)
	<b>\$ 6,376</b>	<b>\$ 4,694</b>

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

\$ in thousands

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	June 30, 2008	December 31, 2007
Costs incurred on uncompleted contracts	\$ 228,998	\$ 161,604
Estimated earnings	30,900	20,639
	259,898	182,243
Less billings to date	(256,248)	(178,726)
	\$ 3,650	\$ 3,517
Included in the accompanying consolidated balance sheets under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted contracts	\$ 15,905	\$ 11,541
Billings in excess of costs and estimated earnings on uncompleted contracts	(12,255)	(8,024)
	\$ 3,650	\$ 3,517



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

**5. Goodwill and Intangible Assets**  
\$ in thousands

Goodwill / Tradename	June 30, 2008		December 31, 2007	
	Goodwill	Tradename	Goodwill	Tradename
Beginning balance	\$ 14,761	\$ 2,095	\$ 9,527	\$ 1,395
Acquisitions	12,030	800	5,234	700
	\$ 26,791	\$ 2,895	\$ 14,761	\$ 2,095

Intangible assets	finite life	June 30, 2008		December 31, 2007	
		Cost	Accum. Amort.	Cost	Accum. Amort.
Patents		\$ 1,406	\$ 886	\$ 1,342	\$ 844
Backlog		1,204	570	304	169
Customer Lists		1,300	197	800	83
Employment contracts		350	99	180	50
		\$ 4,260	\$ 1,752	\$ 2,626	\$ 1,146

Indefinite life intangible assets are comprised of tradenames, while finite life intangible assets are comprised of patents, backlog, customer lists and employment contracts. Amortization of finite life intangibles is on a straight line basis and amortization expense for the three months and six months ended June 30, 2008 was \$393,000 and \$606,000 respectively. Over the next five years amortization expense for these finite life intangible assets will be \$694,000 for the remainder of 2008, \$608,000 in 2009, \$408,000 in 2010, \$350,000 in 2011 and \$257,000 in 2012.

**6. 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 consolidated financial statements herein reflect the operating results of the segment.

**7. Earnings Per Share**

For the three months ended June 30, 2008 and 2007, basic weighted average common shares outstanding were 14,780,369 and 13,000,124, respectively, while diluted average common shares outstanding were 15,207,924 and 13,577,836, respectively.



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(unaudited)

For the six months ended June 30, 2008 and 2007, basic weighted average common shares outstanding were 14,735,290 and 12,251,694, respectively while diluted average common shares outstanding were 15,186,105 and 12,848,505, respectively. We consider outstanding options and warrants in computing diluted net income per share only when they are dilutive. Options and warrants to purchase 385,000 shares for the three months and six months ended June 30, 2008 were not included in the computation of diluted earnings per share due to their exercise price being greater than the market price of the stock.

**8. Debt**

Total bank debt at June 30, 2008 was \$19.8 million and \$4.7 million at December 31, 2007. The bank debt at June 30, 2008 includes \$15.1 million due on the revolving line of credit. Unused credit availability under our \$30.0 million revolving line of credit at June 30, 2008 was \$ 6.9 million. Availability is limited as determined by a borrowing base formula contained in the credit agreement.

In connection with the acquisition of Fisher-Klosterman, Inc. ( FKI ) our credit facility (the Bank Facility ) was amended on February 29, 2008. The amended agreement was entered into by CECO Environmental Corp., the CECO group of companies, FKI Acquisition Corp. and Fifth Third Bank, an Ohio banking corporation. The Bank Facility, as amended, consisted of a new term loan in the amount of \$5.0 million and an increased revolving line of credit of up to \$30.0 million. Credit availability is determined under our revolver on an asset based calculation which is determined by multiplying qualified accounts receivable times a factor of 70% and raw material inventories by a factor of 50%. This resulting availability is then reduced by outstanding letters of credit. Terms of the agreement, which runs through January 31, 2010, include a continuation of the current borrowing rates for the credit line of LIBOR plus 2% and rates for the term note of LIBOR plus 2.25%. Fees paid in connection with this amendment were \$72,000 and we deferred these fees and began amortizing them as an adjustment to interest expense over the remaining term of the arrangement.

**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:

\$ in thousands	Three Months Ended		Six Months Ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Retirement plan:				
Service cost	\$ 44	\$ 37	\$ 88	\$ 74

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Interest cost	91	81	182	162
Expected return on plan assets	(105)	(99)	(210)	(198)
Amortization of prior service cost	2	2	4	4
Amortization of net actuarial loss	35	35	70	70
Net periodic benefit cost	\$ 67	\$ 56	\$ 134	\$ 112

Health care plan:

Interest cost	\$ 4	\$ 5	\$ 8	\$ 10
Amortization of gain	(1)		(3)	
Net periodic benefit cost	\$ 3	\$ 5	\$ 5	\$ 10

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(unaudited)

We previously disclosed in our financial statements for the year ended December 31, 2007 that we expected to make \$615,000 in contributions to the Pension Plan during the year ending December 31, 2008. As of June 30, 2008, \$254,000 has been contributed to the Pension Plan and we plan on paying the balance of \$361,000 during the remainder of Fiscal Year 2008.

The funded status for our post-retirement health care plan is calculated based on the accumulated post-retirement benefit obligation.

**10. Stock-Based Compensation**

The Company accounts for stock-based compensation in accordance with SFAS No. 123(R), Share-Based Payment. SFAS No. 123(R) requires the Company to recognize compensation expense for stock-based awards, measured at the fair value of the awards at the grant date. The Company recognized expense of approximately \$304,000 and \$94,000 during the quarters ended June 30, 2008 and 2007, respectively and \$558,000 and \$144,000 for the six months ended June 30, 2008 and 2007, respectively.

During 2008, the Company awarded 40,900 shares of performance-based, restricted stock with a fair value of \$6.35 per share which vest subject to attainment of predetermined Company performance goals by fiscal year end 2008. These shares will vest on March 31, 2009, if certain minimum financial targets are attained. If the minimum level of performance is not attained by the end of 2008, these stock awards will be forfeited and all expense recognized to date will be reversed. Additionally, a total of 8,000 shares of restricted stock with a fair value of \$7.19 per share were granted to four independent directors. These shares vest over a one year period.

**11. Acquisition**

On February 29, 2008, the Company, through its wholly owned subsidiary FKI Acquisition Corp., purchased substantially all of the assets of Fisher-Klosterman, Inc. ( FKI ). We acquired FKI to obtain air pollution and particulate recovery products in the fields of petroleum refinery, power production, petrochemicals, and manufacturing. The acquisition also expands our operations into China with FKI's 40,000 square foot facility in Shanghai, China. The purchase price was approximately \$23.3 million, consisting of net cash paid plus transaction costs totaling approximately \$15.3 million, liabilities assumed of approximately \$7.1 million and 98,580 shares of restricted common stock valued at \$0.9 million. Additionally, the former owners of FKI are entitled to earn-out payments payable in shares of common stock of up to \$3.5 million upon the attainment of specified gross profit amounts beginning March 1, 2008 through February 28, 2011. The following table summarizes the approximate fair values of the assets acquired and liabilities assumed at the date of closing.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

\$ in thousands

Current assets	\$ 7,064
Other assets	41
Property and equipment	1,823
Intangible assets finite life	1,634
Intangible assets indefinite life	800
Goodwill	11,957
Total assets acquired	23,319
Current liabilities assumed	(7,074)
Net assets acquired	\$ 16,245

The purchase price allocation is preliminary and subject to further refinement based upon completion of asset valuations.

The following unaudited pro forma information represents the Company's results of operations as if the acquisition had occurred on the first day of each of the respective periods

Six Months Ended June 30

	2008	2007
Net sales	\$ 110,200	\$ 125,637
Net income	\$ 574	\$ 2,754
Earnings per share:		
Basic	\$ .04	\$ 0.22
Diluted	\$ .04	\$ 0.21

**12. Income Taxes**

The Company files income tax returns in the 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 2004.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. As a result of the implementation of Interpretation 48, the Company recognized approximately a \$653,000 increase in the liability for unrecognized tax expense, which was accounted for as a reduction to the January 1, 2007 balance of accumulated earnings. For the year ended December, 31, 2007, the Company recorded additional unrecognized tax benefits of \$244,000 for tax positions relating to prior years and a reduction for tax

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positions relating to prior years of \$422,000. Therefore, the unrecognized tax benefit as of December 31, 2007, was \$475,000. Included in the balance at December 31, 2007, 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 December 31, 2007.

As of June 30, 2008, the unrecognized tax benefit was \$499,000 which includes additional interest and penalties.

### **13. Comprehensive Income**

Comprehensive income consists of net income, changes in the minimum pension liability, and translation gains and losses for foreign operations. Comprehensive income totaled \$1,038,000 and \$1,145,000 during the quarters ended June 30, 2008 and 2007, respectively and \$465,000 and \$2,288,000 for the six months ended June 30, 2008 and 2007, respectively.

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(unaudited)

**14. 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 of including installation. The change in accrued warranty expense is summarized in the following table:

\$ in thousands	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Beginning balance	\$ 578	\$ 521	\$ 605	\$ 24
Provision	25	87	50	110
Payments	(29)	(72)	(81)	(87)
Acquisition				489
Ending balance	\$ 574	\$ 536	\$ 574	\$ 536

**15. Subsequent events**

On August 1, 2008, CECO Environmental Corp. (the Company), through a subsidiary, acquired all of the stock of Flextor Inc., a Quebec company (Flextor), pursuant to the terms of a Stock Purchase Agreement (the SPA) dated August 1, 2008, among the Company, 9199-3626 Quebec Inc., Michael dos Santos, The Dos Santos Family Trust, Thierry Allegrucci, The Allegrucci Family Trust, Francois Rouviere and Antandamy Investments Inc. Flextor is a provider of engineered-to-order dampers and expansion joints for the power, natural gas, cement, smelting, incineration, and other industries.

Fisher-Klosterman, Inc. (FKI), a subsidiary of the Company, purchased all of the assets and assumed certain liabilities of Shideler, Inc. (f/k/a/ A.V.C. Specialists, Inc.) (AVC) on August 1, 2008 pursuant to an Asset Purchase Agreement (the APA) dated August 1, 2008 by and among FKI, AVC, and Thomas J. Shideler and Barbara Shideler.

The consideration paid for Flextor and AVC is approximately \$8 million cash in the aggregate, subject, with respect to Flextor, certain adjustments, including a three year earn-out.

In connection with the Flextor acquisition, the Company issued a Subordinated Convertible Promissory Note (the Note) on July 31, 2008 in the amount of Canadian \$5,000,000 (the Subordinated Debt) to Phillip DeZwirek, the Chairman and CEO of the Company. The Note provides 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. Interest payments are payable semi-annually subject to the Subordination Agreement with the Lender. The holder of the Note may convert at any time, commencing August 4, 2008, the outstanding principal and accrued and unpaid interest under the Note into common stock of the Company at a per share price of \$5.83, the closing consolidated bid price immediately preceding the entering into of the Note.



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The Note's maturity date is the earlier of July 31, 2010 or six (6) months after repayment of the Bank Facility. The Note also matures in the event of (i) a merger or reorganization of the Company that results in a change of control, (ii) the sale of 50% of the assets of the Company, or (iii) any sale of any division of the Company in excess of \$5 million.

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CECO ENVIRONMENTAL CORP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

The acquisitions were financed with the proceeds of such subordinated debt and from the Company's Bank Facility.

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(unaudited)

**ITEM 2. Results of Operations**

Our consolidated statements of operations for the three-month and six-month periods ended June 30, 2008 and 2007 reflect our operations consolidated with the operations of our subsidiaries.

(\$ s in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net sales	\$ 57.4	\$ 59.2	\$ 104.3	\$ 102.7
Cost of sales	46.6	49.3	86.8	85.0
Gross profit (excluding depreciation)	\$ 10.8	\$ 9.9	\$ 17.5	\$ 17.7
Percent of sales	18.8%	16.7%	16.8%	17.3%
Selling and administrative expenses	\$ 8.0	\$ 6.2	\$ 14.8	\$ 11.2
Percent of sales	13.9%	10.5%	14.2%	10.9%
Operating income	\$ 2.1	\$ 3.3	\$ 1.3	\$ 5.8
Percent of sales	3.7%	5.6%	1.2%	5.6%

Consolidated net sales for the second quarter decreased 3.0% or \$1.8 million to \$57.4 million in 2008 compared to \$59.2 million in 2007. Consolidated net sales for the first six months of 2008 were \$104.3 million, an increase of \$1.6 million or 1.6% compared to \$102.7 million in 2007. The decrease in revenues for the three months ended June 30, 2008 was due primarily to a decrease in contracting revenues which was substantially offset by increases in parts sales and equipment sales. The equipment sales increases were the result of additional sales from our recently acquired companies, Fisher Klosterman, Inc. (FKI) which was acquired on February 29, 2008 and GMD Environmental (GMD) which was acquired on October 1, 2007. Sales at Effox, Inc. (Effox), acquired February 28, 2007, also increased significantly on a quarter over quarter basis. The comparative six month growth in net sales was also attributable to significant increases in our equipment group sales as the result of our acquisitions of Effox, GMD and FKI plus increases in our component parts business offset by a typical first quarter seasonal decline in sales from our contracting group.

Orders booked were \$54.1 million during the second quarter of 2008 and \$106.9 million for the first six months of 2008, as compared to \$63.3 million during the second quarter of 2007 and \$129.5 million in the first half of 2007.

Second quarter 2008 gross profit was \$10.8 million. This compares to gross profit of \$9.9 million during the same period in 2007. Gross profit as a percentage of revenues for the three-month period ended June 30, 2008 increased 2.1% to 18.8% compared with 16.7% for the comparable period in 2007. This anticipated increase was primarily the result of increased sales of higher margin equipment and component parts offset by reduced margins in our contracting business group including the impact of significant ongoing costs incurred on a large project caused by customer scope changes and site conditions. We continue to anticipate that we will be reimbursed for substantially all of these project costs; however, we will not record the revenue until all revenue recognition criteria have been met.

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Gross profit was \$17.5 million for the first six months of 2008, a decrease of \$.2 million compared to \$17.7 million for the same period in 2007. Gross profit as a percentage of revenues for the first six months of 2008 decreased to 16.8 % compared to 17.3% for the same period in 2007. This decrease was the result of the same factors described for the second quarter further offset when combined with the typical first quarter seasonal decline in sales from our contracting group.

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Selling and administrative expenses increased by \$1.8 million or 29.0% from \$6.2 million to \$8.0 million during the second quarter and increased by \$3.6 million, or 32.1% from \$11.2 million to \$14.8 million during the first six months of 2008 compared to 2007. Selling and administrative expense as a percentage of sales increased from 10.5% to 13.9% for the quarter ended June 30, 2008 and increased from 10.9% to 14.2% for the six months ended June 30, 2008. The increase for the quarter was due primarily to the addition of administrative costs from our new FKI and GMD divisions coupled with increases in selling and administrative wages, non-cash incentive compensation and Sarbanes-Oxley compliance costs. The increase for the six months ended June 30, 2008 was due to these same factors plus six months of selling and administrative costs from Effox for the six month period compared to four months of expenses for the same period in 2007.

Depreciation and amortization expense increased by \$395,000 to \$795,000 during the second quarter of 2008 from \$400,000 in the same period of 2007 and increased by \$660,000 to \$1.4 million in the first six months of 2008 from \$726,000 in the same period of 2007. These increases were the result of additional depreciation for machinery and equipment additions as well as amortization of definite life intangibles related to recent acquisitions.

Operating income was \$2.1 million in the second quarter of 2008, a decrease of \$1.2 million compared to operating income of \$3.3 million during the same quarter of 2007. Operating income as a percent of sales in the second quarter of 2008 was 3.7% compared to 5.6% for the same period in 2007.

Operating income for the first six months of 2008 was \$1.3 million, a decrease of \$4.5 million compared to operating income of \$5.8 million during the same period of 2007. Operating income as a percent of sales for the six months ended June 30, 2008 was 1.2% compared to 5.6% for the same period in 2007.

Higher administrative costs was the primary factor for the decreases in operating income and operating margin percentages.

Interest expense decreased by \$.8 million from \$1.2 million in the second quarter of 2007 to \$.4 million during the second quarter of 2008. Interest expense decreased by \$1.1 million to \$.6 million during the first six months of 2008 compared to \$1.7 million during the first six months of 2007. The decrease for the quarter and six months ended June 30, 2008 was due primarily to the fact that the second quarter of 2007 included a non-cash interest charge of \$740,000 to expense the remaining discount on the subordinated notes that were retired using the proceeds from our secondary stock offering in May 2007 and the resulting elimination of all subordinated debt and a reduction of outstanding bank borrowings on the Company's credit facility. This reduction was partially offset by additional borrowings on February 29, 2008 for the acquisition of FKI.

Federal and state income tax provision was \$.7 million during the second quarter of 2008 compared to \$1.0 million during the second quarter of 2007. Federal and state income tax expense was \$.3 million for the first six months of 2008 compared to a tax expense of \$1.8 million in 2007. The federal and state income tax provision for the first six months of 2008 was 39%, which reflects the estimated effective tax rate for 2008. Our statutory income tax rate is affected by certain permanent differences including income or expense for market valuation of warrants, non-deductible interest expense related to the subordinated debt and non-deductible expense related to incentive stock options.

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Net Income for the quarter ended June 30, 2008 was \$1.0 million compared with net income of \$1.1 million for the same period in 2007. Net income for the six months ended June 30, 2008 was \$.5 million compared with a net income of \$2.3 million for the same period in 2007.

**Backlog**

Our backlog consists of the amount of revenues we expect from full performance of open, signed, firm fixed price contracts that have not been completed for products and services we expect to substantially deliver within the next 12 months. Our backlog, as of June 30, 2008 was \$88.1 million compared to \$85.5 million as of December 31, 2007. 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.

**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, 2008 and December 31, 2007, cash and cash equivalents totaled \$863,000 and \$656,000 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 at June 30, 2008 was \$19.8 million and \$4.7 million at December 31, 2007. The bank debt at June 30, 2008 includes \$15.1 million due on the revolving line of credit. Unused credit availability under our \$30.0 million revolving line of credit at June 30, 2008 was \$6.9 million. Availability is limited as determined by a borrowing base formula contained in the credit agreement.

In connection with the acquisition of Fisher-Klosterman, Inc. ( FKI ) our credit facility (the Bank Facility ) was amended on February 29, 2008. The amended agreement was entered into by CECO Environmental Corp., the CECO group of companies, FKI Acquisition Corp. and Fifth Third Bank, an Ohio banking corporation. The Bank Facility, as amended, consisted of a new term loan in the amount of \$5.0 million and an increased revolving line of credit of up to \$30.0 million. Credit availability is determined under our revolver on an asset based calculation which is determined by multiplying qualified accounts receivable times a factor of 70% and raw material inventories by a factor of 50%. This resulting availability is then reduced by outstanding letters of credit. Terms of the agreement, which runs through January 31, 2010, include a continuation of the current borrowing rates for the credit line of LIBOR plus 2% and rates for the term note of LIBOR plus 2.25%. Fees paid in connection with this amendment were \$72,000 and we deferred these fees and began amortizing them as an adjustment to interest expense over the remaining term of the arrangement.

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**Overview of Cash Flows and Liquidity**

(\$ s in thousands)	For the six months ended June 30,	
	2008	2007
Net cash provided by operating activities	\$ 1,657	\$ 3,464
Net cash used in investing activities	(16,621)	(7,538)
Net cash provided by financing activities	15,171	4,215
Net increase	\$ 207	\$ 141

Cash provided by operating activities was \$1.7 million in 2008 compared to cash provided by operating activities in 2007 of \$3.5 million. Cash provided by operating activities for the first six months of 2008 was primarily the result of net income of \$.5 million, non cash depreciation expense of \$1.4 million, non cash compensation expense for stock awards of \$558,000, a decrease of \$11.6 million in accounts receivable and an increase in billings in excess of costs and estimated earnings on uncompleted contracts of \$1.9 million offset by an decrease in accounts payable of \$10.2 million, a decrease in costs and estimated earnings in excess of billings and estimated earnings of \$2.8 million and an increase in inventories of \$1.1 million. Other changes in working capital items provided cash of \$ 191,000. Our net investment in working capital (excluding cash and cash equivalents and current portion of debt) at June 30, 2008 and December 31, 2007 was \$21.5 million and \$20.8 million, respectively.

Net cash used in investing activities related to the acquisition of property and equipment was \$1.3 million for the first six months of 2008 compared with \$583,000 for the same period in 2007. Net cash used for the acquisition of FKL, which was financed by additional borrowings on the Company's credit facility, amounted to \$15.3 million. We are managing our capital expenditure spending in light of the current level of sales. We anticipate increased capital spending in 2008 which will be funded with cash provided by operating activities and additional borrowings on our revolving credit facility.

Financing activities provided cash of \$15.2 million during the first six months of 2008 compared with cash provided by financing activities of \$4.2 million during the same period of 2007. This consisted of additional borrowing on the credit facility of \$10.4 million and new term debt of \$5.0 million offset by debt repayments of \$250,000.

**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, similar expressions to identify forward-looking statements. Forward-looking statements are based on management's current expectations of our near-term results, based on current information available pertaining to us and are inherently uncertain. We 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: 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;

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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



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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. 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.

The remaining amount of loans outstanding under the Credit Agreement bear interest at the floating rates as described in Note 9 to the consolidated financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission.

Raw Materials

The profitability of our manufactured products is affected by changing purchase prices of steel and other materials. If higher steel or other material prices cannot be passed on to our customers, operating income will be adversely affected.

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**ITEM 4. 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 not 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. This conclusion was based on the existence of the material weaknesses in our Financial Close and Reporting Process, Information Technology Applications and Infrastructure, Segregation of Duties, and Entity-level Controls as further disclosed in Item 9A (Management's Annual Report on Internal Control Over Financial Reporting) in the Company's annual report on Form 10-K for the year ended December 31, 2007 (the 2007 Form 10-K). A more complete description of these material weaknesses can be found in Item 9A of the 2007 Form 10-K. We acquired the assets of FKI on February 29, 2008, and it represented approximately 21% of our total assets as of June 30, 2008. As the acquisition occurred during the last 12 months, the scope of our assessment of the effectiveness of internal control over financial reporting does not include FKI. This exclusion is in accordance with the SEC's general guidance that an assessment of a recently acquired business may be omitted from our scope in the year of acquisition.

The Company is in the process of developing and implementing a remediation plan to address the material weaknesses described above. The Company has taken the following actions to improve internal control over financial reporting:

Since December 31, 2007, the Finance division has been strengthened by the addition of an Assistant Controller in the Financial Analysis and General Accounting areas. The Company plans to continue to enhance the staffing and competency level within the Finance division.

We have engaged four third party professionals to advise the Company in connection with (1) the remediation of existing deficiencies including the conversion to a new information technology enterprise management system, (2) SEC related activities including accounting guidance and periodic reporting, (3) all tax related activities and (4) valuation of goodwill and intangibles. In addition, the following are specific remedial actions to be taken for matters related to accounting for significant or non-routine transactions:

Require all significant or non-routine transactions to be thoroughly researched, analyzed, and documented by qualified accounting personnel. In addition, all major transactions will require the additional review and approval of the Chief Financial Officer.

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In addition to the review performed by the Company's management, implement an additional review by subject matter experts for complex accounting estimates and accounting treatments, where appropriate.

Develop and implement focused monitoring controls and other procedures in the Internal Audit organization.

Develop and implement written policies and procedures governing the financial close and reporting process.

Develop and implement effective communications of and education on a control framework and effectively communicate management's expectations for controls, and business process owners' accountability for controls.

The Company has purchased and is in the process of implementing an integrated software system which includes industry standard and current best practice inherent controls. The new system is expected to address and remediate deficiencies including segregation of duties, security (through access restriction limited to job responsibilities), change control procedures, and reduced use of spreadsheets in preparing financials.

We anticipate the actions described above and resulting improvements in controls will strengthen our internal control over financial reporting and will, over time, address the identified material weaknesses. However, because the remedial actions relate to the hiring of additional personnel and many of the controls in our system of internal controls rely extensively on manual review and approval, the successful operation of these new controls for, at least several quarters may be required prior to management being able to conclude that the material weaknesses have been remediated.

The Company is committed to continuing to improve its internal control processes and will continue to review its disclosure controls and procedures and internal control over financial reporting. As management continues to evaluate and work to improve the Company's controls, additional control deficiencies may be identified. Further, management may determine to take additional measures to address control deficiencies.

Other than as described above, there have been no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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At its Annual Meeting on May 21, 2008, the shareholders of CECO Environmental Corp. took the following actions:

1. Elected the following seven directors, constituting the entire Board of Directors, for terms to expire at the 2009 Annual Meeting of Shareholders, with votes as indicated opposite each director's name:

	<b>Votes For</b>	<b>Votes Withheld</b>
Richard J. Blum	10,110,897	3,474,355
Arthur Cape	10,172,976	3,412,276
Jason DeZwirek	10,038,477	3,546,775
Phillip DeZwirek	9,678,030	3,907,222
Thomas J. Flaherty	11,604,007	1,981,245
Ronald E. Krieg	10,172,676	3,412,576
Donald A. Wright	10,173,576	3,411,676

2. Ratified the appointment of Battelle and Battelle, LLP as the Company's independent registered accounting firm for the fiscal year ending December 31, 2008 as follows:

Votes for: 13,531,401  
 Votes against: 41,138  
 Abstain: 12,710

**ITEM 6. EXHIBITS**

- 10.1 Restricted Stock Award Agreement of Thomas J. Flaherty dated May 21, 2008
- 10.2 Restricted Stock Award Agreement of Arthur Cape dated May 21, 2008
- 10.3 Restricted Stock Award Agreement of Ronald E. Krieg dated May 21, 2008
- 10.4 Restricted Stock Award Agreement of Donald A. Wright dated May 21, 2008
- 10.5 Restricted Stock Award Agreement of David D. Blum dated May 29, 2008
- 10.6 Restricted Stock Award Agreement of Richard J. Blum dated May 29, 2008
- 10.7 Restricted Stock Award Agreement of Dennis W. Blazer dated May 29, 2008
- 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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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, 2008