

CECO ENVIRONMENTAL CORP  
Form 10-Q  
November 08, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2016

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. 0-7099

CECO ENVIRONMENTAL CORP.

(Exact name of registrant as specified in its charter)

Delaware 13-2566064  
(State or other jurisdiction of (IRS Employer

Incorporation or organization) Identification No.)

4625 Red Bank Road, Cincinnati, Ohio 45227  
(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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large Accelerated Filer Accelerated Filer

Non-Accelerated Filer Smaller reporting company

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

The number of shares outstanding of each of the issuer's classes of common equity, as of the latest practical date:  
34,161,493 shares of common stock, par value \$0.01 per share, as of November 3, 2016.

CECO ENVIRONMENTAL CORP. AND SUBSIDIARIES

QUARTERLY REPORT ON FORM 10-Q

For the quarter ended September 30, 2016

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Signatures

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## CECO ENVIRONMENTAL CORP. AND SUBSIDIARIES

## PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS  
CONDENSED CONSOLIDATED BALANCE SHEETS

	(unaudited)	
	SEPTEMBER 30,	DECEMBER 31,
(dollars in thousands, except per share data)	2016	2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 41,814	\$ 34,194
Restricted cash	1,427	5,319
Accounts receivable, net	83,359	97,778
Costs and estimated earnings in excess of billings on uncompleted contracts	38,370	43,175
Inventories, net	23,945	32,509
Prepaid expenses and other current assets	14,759	9,058
Prepaid income taxes	1,595	4,724
Assets held for sale	8,086	1,699
Total current assets	213,355	228,456
Property, plant and equipment, net	28,773	44,981
Goodwill	224,531	220,163
Intangible assets-finite life, net	63,976	74,957
Intangible assets-indefinite life	26,393	26,337
Deferred charges and other assets	4,930	3,925
	\$ 561,958	\$ 598,819
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of debt	\$ 10,216	\$ 19,494
Accounts payable and accrued expenses	90,076	99,097
Billings in excess of costs and estimated earnings on uncompleted contracts	34,854	28,000
Note payable	5,300	—
Income taxes payable	4,236	1,582
Total current liabilities	144,682	148,173
Other liabilities	34,165	30,072
Debt, less current portion	123,231	157,834
Deferred income tax liability, net	15,416	17,719
Total liabilities	317,494	353,798

## Commitments and contingencies

## Shareholders' equity:

Preferred stock, \$.01 par value; 10,000 shares authorized, none issued	—	—
Common stock, \$.01 par value; 100,000,000 shares authorized, 34,148,585 and 34,055,749 shares issued 2016 and 2015, respectively	341	340
Capital in excess of par value	244,316	243,274
Accumulated earnings	11,688	5,472
Accumulated other comprehensive loss	(11,525 )	(9,577 )
	244,820	239,509
Less treasury stock, at cost, 137,920 shares in 2016 and 2015	(356 )	(356 )
Total CECO shareholders' equity	244,464	239,153
Noncontrolling interest	-	5,868
Total shareholders' equity	244,464	245,021
	\$ 561,958	\$ 598,819

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

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(dollars in thousands, except per share data)	THREE MONTHS ENDED		NINE MONTHS ENDED	
	SEPTEMBER 30,		SEPTEMBER 30,	
	2016	2015	2016	2015
Net sales	\$ 101,596	\$ 98,230	\$ 317,029	\$ 266,176
Cost of sales	67,920	67,435	217,837	187,778
Gross profit	33,676	30,795	99,192	78,398
Selling and administrative expenses	19,549	18,054	60,625	46,158
Acquisition and integration expenses	163	5,685	524	6,978
Amortization and earn-out expenses	3,465	9,250	13,176	19,989
Income (loss) from operations	10,499	(2,194 )	24,867	5,273
Other income (expense), net	14	(282 )	395	(1,456 )
Interest expense	(1,913 )	(1,711 )	(5,995 )	(3,845 )
Income (loss) before income taxes	8,600	(4,187 )	19,267	(28 )
Income tax expense	2,774	638	6,349	2,495
Net income (loss)	\$ 5,826	\$ (4,825 )	\$ 12,918	\$ (2,523 )
Net income (loss) attributable to noncontrolling interest	\$ 22	\$ —	\$ (36 )	\$ —
Net income (loss) attributable to CECO Environmental Corp.	\$ 5,804	\$ (4,825 )	\$ 12,954	\$ (2,523 )
Earnings (loss) per share:				
Basic	\$ 0.17	\$ (0.17 )	\$ 0.38	\$ (0.09 )
Diluted	\$ 0.17	\$ (0.17 )	\$ 0.38	\$ (0.09 )
Weighted average number of common shares outstanding:				
Basic	33,983,708	28,617,589	33,952,768	27,066,072
Diluted	34,354,687	28,617,589	34,211,067	27,066,072

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

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(unaudited)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
(dollars in thousands)	SEPTEMBER 30, 2016	SEPTEMBER 30, 2015	SEPTEMBER 30, 2016	SEPTEMBER 30, 2015
Net income (loss)	\$ 5,826	\$ (4,825 )	\$ 12,918	\$ (2,523)
Other comprehensive income (loss), net of tax:				
Interest rate swap	201	—	(422 )	—
Foreign currency translation	(73 )	(1,575 )	(1,526 )	(2,104)
Comprehensive income (loss)	5,954	(6,400 )	10,970	(4,627)
Net income (loss) attributable to noncontrolling interest	22	—	(36 )	—
Comprehensive income (loss) attributable to CECO Environmental Corp.	\$ 5,976	\$ (6,400 )	\$ 10,934	\$ (4,627)

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



## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	NINE MONTHS ENDED	
(dollars in thousands)	SEPTEMBER 30, 2016	2015
Cash flows from operating activities:		
Net income (loss)	\$12,918	\$(2,523 )
Adjustment to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	15,017	11,217
Unrealized foreign currency (gain) loss	(620 )	1,689
Net loss on interest rate swaps	342	—
Fair value adjustments to earnout liabilities	460	9,889
Loss on sale of property and equipment	199	222
Non-cash interest expense	803	791
Share-based compensation expense	1,724	1,318
Bad debt expense	324	504
Inventory reserve expense	964	463
Deferred income taxes	(1,111 )	(657 )
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	15,221	(16,635 )
Costs and estimated earnings in excess of billings on uncompleted contracts	3,449	(10,522 )
Inventories	7,526	170
Prepaid expense and other current assets	(2,907 )	286
Deferred charges and other assets	1,068	201
Accounts payable and accrued expenses	(10,010)	2,354
Billings in excess of costs and estimated earnings on uncompleted contracts	6,859	(252 )
Income taxes payable	2,608	274
Other liabilities	(1,955 )	(7,655 )
Net cash provided by (used in) operating activities	52,879	(8,866 )
Cash flows from investing activities:		
Acquisitions of property and equipment	(811 )	(526 )
Proceeds from sale of property and equipment	301	2,396
Net cash paid for acquisition	—	(37,130 )
Net cash used in investing activities	(510 )	(35,260 )
Cash flows from financing activities:		
Decrease in short-term and long-term restricted cash	2,853	100
Net repayments on revolving credit lines	(13,142)	(1,242 )
Borrowings of long-term debt	—	170,000
Repayments of debt	(31,631)	(101,966)
Financing fees paid	—	(2,923 )
Payoff of loans on life insurance policies	(987 )	—
Acquisition earnout payments	(9,270 )	(1,755 )
Proceeds from sale-leaseback transactions	14,244	—
Payments on capital lease and sale-leaseback financing liability	(241 )	—

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Proceeds from employee stock purchase plan and exercise of stock options	763	298
Repurchases of common stock	(188 )	—
Dividends paid to common shareholders	(6,738 )	(5,734 )
Net cash provided by (used in) financing activities	(44,337)	56,778
Effect of exchange rate changes on cash and cash equivalents	(412 )	(51 )
Net increase in cash and cash equivalents	7,620	12,601
Cash and cash equivalents at beginning of period	34,194	18,162
Cash and cash equivalents at end of period	\$41,814	\$30,763
Cash paid during the period for		
Interest	\$5,375	\$2,965
Income taxes	\$2,344	\$1,812
Non-cash transactions		
Property, plant and equipment acquired under capital leases	\$4,385	\$—
Common stock issued in business acquisition	\$—	\$72,145
Noncontrolling interest acquired through an issuance of a note payable (See Note 17)	\$5,300	\$—
Earnout settled through an exchange of accounts receivable	\$3,272	\$—

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

CECO ENVIRONMENTAL CORP. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Reporting for Consolidated Financial Statements

The accompanying unaudited condensed consolidated financial statements of CECO Environmental Corp. and its subsidiaries (the “Company”, “we”, “us”, or “our”) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, the accompanying unaudited condensed consolidated financial statements of the Company contain all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the financial position as of September 30, 2016 and the results of operations and cash flows for the three-month and nine-month periods ended September 30, 2016 and 2015. The results of operations for the three-month and nine-month periods ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year. The balance sheet as of December 31, 2015 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, 2015 as filed with the SEC.

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

These financial statements and accompanying notes should be read in conjunction with the audited financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC.

Unless otherwise indicated, all balances within tables are in thousands, except per share amounts.

On September 3, 2015, the Company completed the acquisition of PMFG, Inc. (“PMFG”). The results of its operations have been consolidated with our results following the acquisition date. For a more complete discussion of the transaction, refer to Note 17.

The Company’s consolidated financial statements include the accounts of all wholly-owned and majority-owned subsidiaries for all periods presented. All significant inter-company accounts and transactions have been eliminated in consolidation. On July 12, 2016, the Company entered into an agreement with the noncontrolling owner of Peerless Propulsys China Holdings LLC (“Peerless Propulsys”) to acquire 100% ownership in the equity and earnings of Peerless Propulsys of their interest (40%). For a more complete discussion of the transaction, refer to Note 17.

## 2. New Financial Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments”. ASU 2016-15 provides guidance on how certain cash receipts and cash payments are presented and classified in the statement of cash flows. ASU 2016-15 is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. ASU 2016-15 will require adoption on a retrospective basis, unless it is impracticable to apply, in which case we would be required to apply the amendments prospectively as of the earliest date practicable. Early adoption is permitted, including adoption in an interim period. The Company is currently in the process of evaluating the impact of ASU 2016-15 on its consolidated financial statements.

In May 2016, the FASB issued ASU 2016-12, “Revenue from Contracts with Customers, Narrow-Scope Improvements and Practical Expedients”, clarifying the implementation guidance on narrow scope improvements and practical expedients related to FASB ASU 2014-09, “Revenue from Contracts with Customers”. The improvements address completed contracts and contract modifications at transition, non-cash consideration, the presentation of sales taxes and other taxes collected from customers, and assessment of collectability when determining whether a transaction represents a valid contract. In April 2016, the FASB issued ASU 2016-10, “Revenue from Contracts with Customers, Identifying Performance Obligations and Licensing” clarifying the implementation guidance on identifying performance obligations and licensing related to FASB ASU 2014-09, “Revenue from Contracts with Customers”. The amendments reduce the cost and complexity of identifying promised goods or services and improve the guidance for determining whether promises are separately identifiable. These pronouncements have the same effective date as the new revenue standard, which is effective for fiscal years, and interim

periods within those fiscal years, beginning after December 15, 2017. The Company is currently evaluating the impact of the adoption of these standards on the Company's consolidated financial statements and has not yet determined the method of adoption.

In March 2016, the FASB issued ASU 2016-09, "Compensation—Stock Compensation: Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 introduces targeted amendments intended to simplify the accounting for stock compensation. Specifically, the ASU requires all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) to be recognized as income tax expense or benefit in the income statement. The tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur. An entity also should recognize excess tax benefits, and assess the need for a valuation allowance, regardless of whether the benefit reduces taxes payable in the current period. That is, off-balance sheet accounting for net operating losses stemming from excess tax benefits would no longer be required and instead such net operating losses would be recognized when they arise. Existing net operating losses that are currently tracked off balance sheet would be recognized, net of a valuation allowance if required, through an adjustment to opening retained earnings in the period of adoption. Entities will no longer need to maintain and track an "APIC pool." The ASU also requires excess tax benefits to be classified along with other income tax cash flows as an operating activity in the statement of cash flows. In addition, ASU 2016-09 elevates the statutory tax withholding threshold to qualify for equity classification up to the maximum statutory tax rates in the applicable jurisdiction(s). The ASU also clarifies that cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity. ASU 2016-09 provides an optional accounting policy election (with limited exceptions), to be applied on an entity-wide basis, to either estimate the number of awards that are expected to vest (consistent with existing U.S. GAAP) or account for forfeitures when they occur. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company is currently evaluating the potential impact of the adoption of this standard on the Company's consolidated financial statements.

In March 2016, the FASB issued ASU 2016-05, "Derivatives and Hedging: Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships." ASU 2016-05 amends Topic 815 to clarify that novation of a derivative (replacing one of the parties to a derivative instrument with a new party) designated as the hedging instrument would not, in and of itself, be considered a termination of the derivative instrument or a change in critical terms requiring discontinuation of the designated hedging relationship. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company is currently evaluating the potential impact of the adoption of this standard on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases." ASU 2016-02 establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the potential impact of the adoption of ASU 2016-02 on the Company's consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory." ASU 2015-11 requires inventory within the scope of the ASU (e.g., first-in, first-out ("FIFO") or average cost) to be measured using the lower of cost and net realizable value. Inventory excluded from the scope of the ASU (i.e., last-in, first-out ("LIFO") or the retail inventory method) will continue to be measured at the lower of cost or market. The ASU also amends some of the other guidance in Topic 330, "Inventory," to more clearly articulate the requirements for the measurement and disclosure of inventory. However, those amendments are not intended to result in any changes to current practice. ASU 2015-11 is effective for annual periods beginning after December 15, 2016, and interim periods within those

annual periods. The adoption of this standard is not expected to have a significant impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue From Contracts With Customers." ASU 2014-09 supersedes nearly all existing revenue recognition principles under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration an entity expects to be entitled to for those goods or services using a defined five step process. More judgment and estimates may be required to achieve this principle than under existing GAAP. ASU 2014-09 is effective for annual periods beginning after December 15, 2017, including interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients or (ii) a retrospective approach with the cumulative effect upon initial adoption recognized at the date of adoption, which includes additional footnote disclosures. The Company is currently evaluating the impact of the adoption of ASU 2014-09 on the

Company's consolidated financial statements and has not yet determined the method of adoption. The Company's current revenue recognition policies are generally consistent with the new revenue recognition standards set forth in ASU 2014-09. Potential adjustments to input measures are not expected to be pervasive to the majority of the Company's contracts. While no significant impact is expected upon adoption of the new guidance, the Company will not be able to make that determination until the time of adoption based upon outstanding contracts at that time.

### 3. Accounts Receivable

	September 30,	December 31,
(Table only in thousands)	2016	2015
Trade receivables	\$ 12,068	\$ 12,800
Contract receivables	72,641	86,129
Allowance for doubtful accounts	(1,350 )	(1,151 )
	\$ 83,359	\$ 97,778

Balances billed but not paid by customers under retainage provisions in contracts amounted to approximately \$2.0 million and \$2.3 million at September 30, 2016 and December 31, 2015, respectively. Retainage receivables on contracts in progress are generally collected within a year after contract completion.

The provision for doubtful accounts was \$30,000 and \$0.4 million for the three-month periods ended September 30, 2016 and 2015, respectively, and \$0.3 million and \$0.5 million for the nine-month periods ended September 30, 2016 and 2015, respectively.

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

Revenues from contracts are primarily recognized on the percentage of completion method, measured by the percentage of contract costs incurred to date compared with estimated total contract costs for each contract. This method is used because management considers contract costs to be the best available measure of progress on these contracts. For contracts where the duration is short, total contract revenue is insignificant, or reasonably dependable estimates cannot be made, revenues are recognized on a completed contract basis, when risk and title passes to the customer, which is generally upon shipment of product. During the second quarter, the Company's Zhongli division within the Energy segment has recognized revenue on a percentage of completion method compared to the completed contracts method that was utilized in previous quarters. This change was made after determining that the Company had designed and implemented appropriate controls to track project costs and estimates to complete. During the three months and nine months periods ended September 30, 2016, this division recognized \$5.2 million and \$13.4 million, respectively, in percentage of completion revenue related to open projects as of September 30, 2016.

Our contracts have various lengths to completion ranging from a few days to several months. We anticipate that a majority of our current contracts will be completed within the next twelve months.

	September 30,	December 31,
(Table only in thousands)	2016	2015
Costs incurred on uncompleted contracts	\$ 192,136	\$ 178,356
Estimated earnings	72,516	64,957
	264,652	243,313
Less billings to date	(261,136 )	(228,138 )
	\$ 3,516	\$ 15,175
Included in the accompanying condensed consolidated		
balance sheets under the following captions:		
Costs and estimated earnings in excess of billings		
on uncompleted contracts	\$ 38,370	\$ 43,175
Billings in excess of costs and estimated		
earnings on uncompleted contracts	34,854	28,000
	\$ 3,516	\$ 15,175



Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes to job performance, job conditions, and estimated profitability may result in revisions to contract revenue and costs and are recognized in the period in which the revisions are made. A provision of \$0.2 million for estimated losses on uncompleted contracts was recognized at September 30, 2016. No provision for estimated losses on uncompleted contracts was required at December 31, 2015.

## 5. Inventories

	September 30,		December 31,	
(Table only in thousands)	2016		2015	
Raw materials	\$ 19,444		\$ 24,339	
Work in process	4,290		6,443	
Finished goods	2,077		2,717	
Obsolescence allowance	(1,866	)	(990	)
	\$ 23,945		\$ 32,509	

Amounts credited to the allowance for obsolete inventory and charged to cost of sales amounted to \$0.1 million and \$0.2 million for the three-month periods ended September 30, 2016 and 2015, respectively, and \$1.0 million and \$0.5 million for the nine-month periods ended September 30, 2016 and 2015, respectively.

## 6. Goodwill and Intangible Assets

	Nine months ended		Year ended	
(Table only in thousands)	September 30, 2016		December 31, 2015	
Goodwill / Tradename	Goodwill	Tradename	Goodwill	Tradename
Beginning balance	\$220,163	\$ 26,337	\$165,861	\$ 19,766
Acquisitions and related adjustments	4,205	—	55,655	10,280
Impairment	—	—	—	(3,340 )
Foreign currency translation	163	56	(1,353 )	(369 )
	\$224,531	\$ 26,393	\$220,163	\$ 26,337

	As of September 30, 2016		As of December 31, 2015	
(Table only in thousands)	Cost	Accum.	Cost	Accum.
Intangible assets – finite life				

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		Amort.		Amort.
Patents	\$1,439	\$1,439	\$1,456	\$1,456
Employment agreements	733	733	733	677
Technology	15,867	5,834	15,867	4,027
Customer lists	77,497	23,929	77,497	17,756
Noncompetition agreements	1,118	423	1,118	257
Tradename	1,390	266	1,390	162
Backlog	4,270	4,270	4,270	1,423
Foreign currency adjustments	(2,102 )	(658 )	(2,309 )	(693 )
	\$100,212	\$36,236	\$100,022	\$25,065

Activity for the nine months ended September 30, 2016 and 2015 is as follows:

(Table only in thousands)	2016	2015
Intangible assets – finite life, net at beginning of period	\$74,957	\$58,398
Amortization expense	(11,123)	(8,513)
Acquisitions and purchase accounting adjustments	—	34,900
Foreign currency adjustments	142	(810)
Intangible assets – finite life, net at end of period	\$63,976	\$83,975

Amortization expense of finite life intangible assets was \$3.5 million and \$3.3 million for the three-month periods ended September 30, 2016 and 2015, respectively, and \$11.1 million and \$8.5 million for the nine-month periods ended September 30, 2016 and 2015, respectively.

The Company completes an annual (or more often if circumstances require) impairment assessment of its goodwill and indefinite life intangible assets as of October 1. For 2015, the first step of the two-step goodwill impairment test as described in FASB ASC 350-20-35 was performed for all reporting units, except for the recently acquired PMFG reporting unit, as there were no events or changes in operations since the acquisition date that would indicate possible impairment.

Under the first step, the Company bases its measurement of the fair value of a reporting unit using a weighting of the income method and the market method on a 50/50 basis. In prior years, the Company used the income method. The income method is based on a discounted future cash flow approach that uses the significant assumptions of projected revenue, projected operational profit, terminal growth rates, and the cost of capital. Projected revenue, projected operational profit and terminal growth rates were determined to be significant assumptions because they are three primary drivers of the projected cash flows in the discounted future cash flow approach. Cost of capital was also determined to be a significant assumption as it is the discount rate used to calculate the current fair value of those projected cash flows. The market method is based on financial multiples of comparable companies and applies a control premium. Significant estimates in the market approach include identifying similar companies with comparable business factors such as size, growth, profitability, risk and return on investment and assessing comparable revenue and operating income multiples in estimating the fair value of a reporting unit. Based on the step 1 analysis, the resultant estimated fair value of the reporting units exceeded their carrying value as of October 1, 2015 and no goodwill impairment charges were recorded.

For one of the reporting units tested under the step 1 analysis in 2015, which carried goodwill of \$77.9 million, the excess of fair value over their carrying value was only 8%. This reporting unit was acquired in the second half of fiscal 2013, and therefore the Company did not expect the fair value to be significantly in excess of the carrying value. Furthermore, there were no fundamental changes in the business or market that would indicate a significant decline in the fair value since the acquisition date. Management's projections used to estimate the undiscounted cash flows included increasing sales volumes and operational improvements designed to reduce costs. Changes in any of the significant assumptions used, including if the Company does not successfully achieve its 2016 operating plan, can materially affect the expected cash flows, and such impacts can result in the requirement to proceed to a step 2 test and potentially a material non-cash impairment charge could result. Therefore, the key assumptions most susceptible to change are projected revenue and projected operational profit. We determined that with other assumptions held constant under our weighted income and market method for measuring fair value, a decrease in projected revenue growth rates of approximately 110 basis points or a decrease in projected EBITDA rates of approximately 390 basis points would result in fair value of the reporting unit being equal to its carrying value, which would require us to perform a step 2 test for this reporting unit.

During 2015, the Company also performed a step 1 analysis for all reporting units with indefinite life intangible assets. The Company based its measurement of the fair value of the indefinite life intangible assets utilizing the relief from royalty method. The significant assumptions used under the relief from royalty method are projected revenue, royalty rates, terminal growth rates, and the cost of capital. Projected revenue, royalty rates and terminal growth rates were determined to be significant assumptions because they are three primary drivers of the projected royalty cash flows in the relief from royalty method. Cost of capital was also determined to be a significant assumption as it is the discount rate used to calculate the current fair value of those projected royalty cash flows. Changes in any of the significant assumptions used, including if the Company does not successfully achieve its 2016 operating plan, can materially affect the expected cash flows, and such impacts can result in material non-cash impairment charges. Under this approach, the resultant estimated fair value of the indefinite life intangible assets exceeded their carrying value for all but three reporting units as of October 1, 2015. For three of the reporting units, which carried combined indefinite life intangible assets of \$10.0 million, our fair value measurement resulted in the aggregate fair value being 33.4% lower than the aggregate carrying value. Accordingly, we recorded an impairment charge of \$3.3 million during the three-month period ended December 31, 2015. These three reporting units were acquired in the

second half of fiscal 2013. Management's projections used to estimate the fair values at the date of acquisition primarily included increasing sales volumes; however, the units have experienced lower sales than originally projected.

The Company did not identify any triggering events during the three-month and nine-month periods ended September 30, 2016 that would require an interim impairment assessment of goodwill or indefinite life intangible assets. There was no impairment of goodwill or indefinite life intangible assets during the three-month and nine-month periods ended September 30, 2016.

Although the Company has not identified any triggering events in 2016 that would require a more frequent test for impairment, the reporting unit with a lower excess fair value over its carrying value (as described above), as determined in the prior year's annual assessment, is experiencing lower than forecasted results through the first nine months of 2016. This reporting unit has goodwill and tradename intangible assets of \$77.9 million and \$5.0 million, respectively, as of September 30, 2016. The Company is currently in the process of analyzing internal strategic initiatives to improve operating performance, and forecasting for 2017 and future years as part of its annual impairment assessment, which is performed as of October 1, and will be completed in the fourth quarter. As of the date of this filing, the Company has not yet completed its assessment.

## 7. Accounts Payable and Accrued Expenses

	September 30, December 31,	
	2016	2015
Trade accounts payable, including due to subcontractors	\$ 57,723	\$ 62,199
Compensation and related benefits	6,405	7,899
Current portion of earn-out liability	11,258	14,757
Accrued warranty	2,696	3,080
Other accrued expenses	11,994	11,162
	\$ 90,076	\$ 99,097

The Company recorded a total of \$9.7 million and \$17.9 million related to the non-current portion of the earn-out liability in “other liabilities” on the Condensed Consolidated Balance Sheets as of September 30, 2016 and December 31, 2015, respectively. In the second quarter of 2016, the Company settled \$3.2 million of the earn-out due by exchanging the liability for accounts receivable acquired in conjunction with the acquisition that remained uncollected as of June 30, 2016. This offset was agreed to in the original terms of the Zhongli acquisition agreement.

## 8. Senior debt

Debt consisted of the following at September 30, 2016 and December 31, 2015:

	September 30, December 31,	
(Table only in thousands)	2016	2015
Outstanding borrowings under Credit Facility (defined below).		
Term loan payable in quarterly principal installments of \$2.1 million through September 2017, \$2.9 million through September 2018, and \$3.6 million thereafter with balance due upon maturity in September 2020.		
- Term loan	\$ 135,209	\$ 166,813
- U.S. Dollar revolving loans	—	8,000
- Unamortized debt discount and debt issuance costs	(3,426 )	(4,229 )
Total outstanding borrowings under Credit Facility	131,783	170,584

Outstanding borrowings (U.S. dollar equivalent) under

China Facility (defined below)	1,355	1,391
Outstanding borrowings (U.S. dollar equivalent) under		
Aarding Facility (defined below)	309	5,326
Outstanding borrowings (U.S. dollar equivalent) under Euro-		
denominated note payable to a bank, payable in quarterly		
installments of €25,000, plus interest, at a fixed rate of		
3.82%, matured in January 2016. Collateralized by the		
Heerenveen, Netherlands building.	—	27
Total outstanding borrowings	133,447	177,328
Less: current portion	10,216	19,494
Total debt, less current portion	\$ 123,231	\$ 157,834

During the three-month and nine-month periods ended September 30, 2016, the Company made prepayments of \$13.0 million and \$23.3 million, respectively, on the outstanding balance of the term loan. These prepayments were applied to future principal payments due under the term loan. Scheduled principal payments under our Credit Facility is \$2.1 million for the remainder of 2016, \$9.3 million in 2017, \$12.1 million in 2018, \$14.3 million in 2019 and \$97.4 million in 2020.

#### United States Debt

As of September 30, 2016 and December 31, 2015, \$16.9 million and \$15.4 million of letters of credit were outstanding, respectively. Total unused credit availability under the Company's senior secured term loan, senior secured U.S. dollar revolving loans with sub-facilities for letters of credit and swing-line loans and senior secured multi-currency revolving credit

facility for U.S. dollar and specific foreign currency loans (collectively, the “Credit Facility”) was \$63.1 million and \$56.6 million at September 30, 2016 and December 31, 2015, respectively. Revolving loans may be borrowed, repaid and reborrowed until September 3, 2020, at which time all amounts borrowed pursuant to the Credit Facility must be repaid.

The weighted average interest rate on outstanding borrowings was 3.19% and 3.42% at September 30, 2016 and December 31, 2015, respectively.

In accordance with the Credit Facility terms, the Company entered into an interest rate swap on December 30, 2015 to hedge against interest rate exposure related to approximately one-third of the outstanding debt indexed to LIBOR market rates. The fair value of the interest rate swap was a liability totaling \$1.2 million and \$0.4 million at September 30, 2016 and December 31, 2015, respectively, which is recorded in “Accounts payable and accrued expenses” on the Condensed Consolidated Balance Sheets. The Company did not designate the interest rate swap as an effective hedge until the first quarter of 2016, and accordingly the change in the fair value until the date of designation of \$0.5 million was recorded in earnings in “Other income (expense), net” in the Condensed Consolidated Statements of Operations for the nine-month period ended September 30, 2016. From the date of designation, all changes to the fair value of the interest rate swap have been recorded in other comprehensive income (loss) as the hedge is deemed effective.

As of September 30, 2016 and December 31, 2015, the Company was in compliance with all related financial and other restrictive covenants under the Credit Agreement.

#### Foreign Debt

A subsidiary of the Company located in the Netherlands has a Euro denominated facilities agreement with ING Bank N.V. (“Aarding Facility”) with a total borrowing capacity of \$14.6 million. As of September 30, 2016 and December 31, 2015, the borrowers were in compliance with all related financial and other restrictive covenants. As of September 30, 2016, \$2.4 million of the bank guarantee and \$0.3 million of the overdraft facility are being used by the borrowers. As of December 31, 2015, \$6.6 million of the bank guarantee and \$5.3 million of the overdraft facility was being used by the Company. There is no stated expiration date on the Aarding Facility.

A subsidiary of the Company located in China has a Chinese Yuan Renminbi denominated short-term loan with Bank of America (“China Facility”) with an amount outstanding of \$1.4 million as of September 30, 2016 at an interest rate of 4.79%, which matures in October 2016 and was subsequently renewed on a short term basis.

#### 9. Earnings and Dividends per Share

The computational components of basic and diluted earnings per share for the three-month and nine-month periods ended September 30, 2016 and 2015 are below.

For the three-month

period ended September 30,  
2016

Numerator Denominator Per  
Share

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	(Income)	(Shares)	Amount
Basic net income and income per share	\$5,804	33,984	\$ 0.17
Effect of dilutive securities and notes:			
Common stock equivalents arising from stock			
options, restricted stock awards, and employee			
stock purchase plan	—	371	—
Diluted earnings and earnings per share	\$5,804	34,355	\$ 0.17

For the three-month

period ended September 30,  
2015

Numerator Denominator Per  
Share

	(Income)	(Shares)	Amount
Basic net loss and loss per share	\$(4,825)	28,618	\$ (0.17 )
Effect of dilutive securities and notes:			
Common stock equivalents arising from stock			
options, restricted stock awards, and employee			
stock purchase plan	—	—	—
Diluted loss and loss per share	\$(4,825)	28,618	\$ (0.17 )



	For the nine-month		
	period ended September 30, 2016		
	Numerator	Denominator	Per Share
	(Income)	(Shares)	Amount
Basic net income and earnings per share	\$ 12,954	33,953	\$ 0.38
Effect of dilutive securities and notes:			
Common stock equivalents arising from stock			
options, restricted stock awards, and employee			
stock purchase plan	—	258	—
Diluted earnings and earnings per share	\$ 12,954	34,211	\$ 0.38

	For the nine-month		
	period ended September 30, 2015		
	Numerator	Denominator	Per Share
	(Income)	(Shares)	Amount
Basic net loss and loss per share	\$(2,523)	27,066	\$ (0.09 )
Effect of dilutive securities and notes:			
Common stock equivalents arising from stock			
options, restricted stock awards, and employee			
stock purchase plan	—	—	—
Diluted loss and loss per share	\$(2,523)	27,066	\$ (0.09 )

Options, restricted stock units and warrants included in the computation of diluted earnings per share are calculated using the treasury stock method. For the three-month periods ended September 30, 2016 and 2015, 1.1 million and 1.3 million, respectively, and 1.4 million and 1.3 million during the nine-month periods ended September 30, 2016 and 2015, respectively, of outstanding options and warrants were excluded from the computation of diluted earnings per share due to their having an anti-dilutive effect.

Once a restricted stock unit vests, it is included in the computation of weighted average shares outstanding for purposes of basic and diluted earnings per share.

On August 8, 2016, the Company declared and, on September 30, 2016, paid to common stockholders a quarterly dividend of \$0.066 per share. The dividend policy and the payment of cash dividends under that policy are subject to the Board of Directors' continuing determination that the dividend policy and the declaration of dividends are in the best interest of the Company's stockholders. Future dividends and the dividend policy may be changed or cancelled at the Company's discretion at any time. Payment of dividends is also subject to the continuing compliance with our financial covenants under our Credit Facility.

#### 10. Share-Based Compensation

The Company accounts for stock-based compensation in accordance with ASC Topic 718, "Compensation – Stock Compensation," which 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 \$0.6 million and \$0.4 million during the three-month periods ended September 30, 2016 and 2015, respectively, and \$1.7 million and \$1.3 million during the nine-month periods ended September 30, 2016 and 2015, respectively.

The Company granted no options during the three-month period ended September 30, 2016 and 154,000 options during the three-month period ended September 30, 2015. The Company granted approximately 100,000 and 250,000 options during the nine-month periods ended September 30, 2016 and 2015, respectively. The weighted-average fair value of stock options granted during the nine months ended September 30, 2016 and 2015 was estimated at \$2.07 and \$4.53 per option, respectively, using the Black-Scholes option-pricing model based on the following assumptions:

**Expected Volatility:** The Company utilizes a volatility factor based on the Company's historical stock prices for a period of time equal to the expected term of the stock option utilizing weekly price observations. For the nine months ended September 30, 2016 and 2015, the Company utilized a weighted-average volatility factor of 39% and 45%, respectively.

**Expected Term:** For the nine months ended September 30, 2016, and 2015, the Company utilized a weighted-average expected term factor of 6.5 years and 6.4 years, respectively.

**Risk-Free Interest Rate:** The risk-free interest rate factor utilized is based upon the implied yields currently available on U.S. Treasury zero-coupon issues over the expected term of the stock options. For the nine months ended September 30, 2016 and 2015, the Company utilized a weighted-average risk-free interest rate factor of 2.1% and 1.9%, respectively.

Expected Dividends: The Company utilized a weighted average expected dividend rate of 3.6% and 2.3% to value options granted during the nine months ended September 30, 2016 and 2015, respectively.

The Company granted approximately 165,000 and 310,000 restricted stock units during the three-month periods ended September 30, 2016 and 2015, respectively, and approximately 270,000 and 320,000 restricted stock units during the nine-month periods ended September 30, 2016 and 2015, respectively. The weighted-average fair value of restricted stock units granted during the nine months periods ended September 30, 2016 and 2015 was estimated at \$9.77 and \$9.48 per unit, respectively, using the value of stock in the open market on the date of grant.

The fair value of the stock-based awards granted is recorded as compensation expense on a straight-line basis over the vesting periods of the awards adjusted for the Company's estimate of pre-vesting forfeitures. The pre-vesting forfeiture estimate is based on historical activity and is reviewed periodically and updated as necessary. There is a portion of the outstanding restricted stock units that have both performance and service-based vesting conditions. The Company has determined that the performance condition is likely to be met. As such, the related expense will be recognized over the service period.

There were approximately 74,000 options exercised during the nine months ended September 30, 2016. The Company received \$0.5 million and \$0.1 million in cash from employees and directors exercising options during the nine months ended September 30, 2016 and 2015, respectively. The intrinsic value of options exercised during the nine months ended September 30, 2016 and 2015 was \$0.2 million.

#### 11. Stock Purchase

During the nine-month period ended September 30, 2016, the Company repurchased 30,000 shares of common stock from a former owner of a subsidiary acquired by the Company in a previous year for a total cost of \$0.2 million. The shares were immediately retired.

#### 12. Pension and 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 postretirement health care plan for office employees retired before January 1, 1990. The plan allowed retirees who 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:

(Table only in thousands)	Three Months Ended	Nine Months Ended
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	September 30,		September 30,	
	2016	2015	2016	2015
<b>Pension plan:</b>				
Service cost	\$112	\$58	\$335	\$175
Interest cost	356	354	1,069	1,060
Expected return on plan assets	(457)	(502)	(1,371)	(1,507)
Amortization of net actuarial loss	53	65	159	194
Net periodic benefit cost (gain)	\$64	\$(25 )	\$192	\$(78 )
<b>Health care plan:</b>				
Interest cost	\$1	\$1	\$3	\$4
Amortization of loss	3	2	8	5
Net periodic benefit cost	\$4	\$3	\$11	\$9

We made contributions to our defined benefit plans during the nine months ended September 30, 2016 and 2015 totaling \$29,000 and \$0.4 million, respectively. We do not anticipate any further contributions to fund the pension plans and anticipate \$25,000 of contributions for the retiree health care plan during the remainder of 2016. The unfunded liability of the plans of \$11.0 million as of September 30, 2016 and December 31, 2015 is included in Other Liabilities on our Condensed Consolidated Balance Sheets.

### 13. Income Taxes

The Company files income tax returns in various federal, state and local jurisdictions. The Company is no longer subject to federal, state and local income tax examinations by tax authorities for years before 2013.

The Company accounts for uncertain tax positions pursuant to ASC Topic 740, "Income Taxes." As of September 30, 2016 and December 31, 2015, the liability for uncertain tax positions totaled approximately \$0.4 million and \$1.0 million, respectively, which is included in Other Liabilities on our Condensed Consolidated Balance Sheets. The Company recognizes interest accrued related to uncertain tax positions in interest expense and penalties in income tax expense. The Company has not recorded deferred income taxes on the undistributed earnings of its foreign subsidiaries because of management's intent to indefinitely reinvest such earnings.

### 14. Financial Instruments

Our financial instruments consist primarily of investments in cash and cash equivalents, receivables and certain other assets, foreign debt and accounts payable, which approximate fair value at September 30, 2016 and December 31, 2015, due to their short-term nature or variable, market-driven interest rates.

The fair value of the debt issued under the Credit Agreement was \$135.2 million and \$174.8 million at September 30, 2016 and December 31, 2015, respectively.

In accordance with the terms of the Credit Agreement, the Company entered into an interest rate swap on December 30, 2015 to hedge against interest rate exposure related to approximately one-third of the outstanding debt indexed to LIBOR market rates. See Note 8 for further information regarding the interest rate swap.

At September 30, 2016 and December 31, 2015, we had cash and cash equivalents of \$41.8 million and \$34.2 million, respectively, of which \$22.0 million and \$18.0 million, respectively, was held outside of the United States, principally in the Netherlands, United Kingdom, China, and Canada.

Restricted cash is held by the Company to support letters of credit issued in foreign jurisdictions to support Company operations. The Company occasionally enters into letters of credit with durations in excess of one year.

### 15. Sale-leaseback Transactions

#### Denton Facility

On June 2, 2016, the Company entered into an agreement to sell its manufacturing facility in Denton, Texas for gross proceeds of \$5.0 million, less costs associated with the transaction of \$0.3 million, or net proceeds of \$4.7 million. As a part of the transaction, the Company entered into a lease for the property from the purchaser for a period of 13 years.

Prior to the consummation of the above transaction, the Company entered into a sublease agreement with a supplier of the Company at this facility for a period of five years. Due to the Company's continuing involvement through the sublease agreement, the Company has accounted for the sale-leaseback as a financing liability. Payments made by the Company are allocated between interest expense and a reduction to the sale-leaseback financing liability. The weighted-average effective interest rate of the sale-leaseback financing liability was 2.22%.

As of September 30, 2016, future payments on the sale-leaseback financing liability are as follows (in thousands):

15

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Fiscal Years	Payments
Remainder of 2016	\$ 98
2017	399
2018	407
2019	415
2020	423
2021	431
Thereafter	3,480
Total payments	5,653
Less amount representing interest	(756 )
Total sale-leaseback financing liability	4,897
Less current portion of sale-leaseback financing liability included in accounts payable and accrued expenses	(291 )
Long-term portion of sale-leaseback financing liability included in other liabilities	\$ 4,606

As of September 30, 2016 and December 31, 2015, the net carrying value of the Denton facility assets that are included in property, plant, and equipment on our Condensed Consolidated Balance Sheets amounted to \$12.6 million and \$13.1 million, respectively. The useful life of these assets was modified to the remainder of the lease's duration.

#### Telford Facility

On June 2, 2016, the Company entered into an agreement to sell its manufacturing facility in Telford, Pennsylvania for gross proceeds of \$6.0 million, less costs associated with the transaction of \$0.4 million, or net proceeds of \$5.6 million. As a part of the transaction, the Company entered into a lease for the property from the purchaser for a period of 13 years.

The Company recorded a deferred gain on the sale of this facility in the amount of \$2.4 million recorded in the Condensed Consolidated Balance Sheets as an offset to property, plant, and equipment, which will be recognized over the 13-year lease term. As a result of this transaction, the Company initially recorded a capital lease obligation of \$5.7 million for the facilities leased. The weighted-average effective interest rate of the capital lease was 3.43%.

#### Indianapolis Facility

On August 16, 2016, the Company entered into an agreement to sell its manufacturing facility in Indianapolis, Indiana for gross proceeds of \$3.3 million, less costs associated with the transaction of \$0.1 million, or net proceeds of \$3.2 million. As a part of the transaction, the Company entered into a lease for the property from the purchaser for a period of 13 years.

The Company recorded a deferred gain on the sale of this facility in the amount of \$2.0 million recorded in the Condensed Consolidated Balance Sheets as an offset to property, plant, and equipment, which will be recognized over the 13-year lease term. As a result of this transaction, the Company initially recorded a capital lease obligation of \$3.0 million for the facilities leased. The weighted-average effective interest rate of the capital lease was 3.25%.

The future minimum payments for both capital leases that the Company entered into as of September 30, 2016, are as follows (in thousands):

16

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Fiscal Years	Payments
Remainder of 2016	\$ 184
2017	744
2018	759
2019	774
2020	790
2021	805
Thereafter	6,577
Total payments	10,633
Less amount representing interest	(2,049 )
Present value of future minimum lease payments	8,584
Less current portion of capital lease obligation included in accounts payable and accrued expenses	(462 )
Long-term portion of capital lease obligation included in other liabilities	\$ 8,122

Prior to the execution of these transactions, the Company did not have any assets held under capital leases. Capital lease assets included in the Condensed Consolidated Balance Sheets as part of property, plant, and equipment as of September 30, 2016, are as follows (in thousands):

	September 30, 2016	Depreciable Life (Years)
Building and improvements, net of deferred gain	\$ 4,385	13
Less: Accumulated depreciation	(113 )	
Total	\$ 4,272	

## 16. Commitments and Contingencies – Legal Matters

### Asbestos cases

Our subsidiary, Met-Pro Technologies LLC (“Met-Pro”), beginning in 2002, began to be named in asbestos-related lawsuits filed against a large number of industrial companies including, in particular, those in the pump and fluid handling industries. In management’s opinion, the complaints typically have been vague, general and speculative, alleging that Met-Pro, along with the numerous other defendants, sold unidentified asbestos-containing products and engaged in other related actions which caused injuries (including death) and loss to the plaintiffs. Counsel has advised that more recent cases typically allege more serious claims of mesothelioma. The Company’s insurers have hired attorneys who, together with the Company, are vigorously defending these cases. Many cases have been dismissed after the plaintiff fails to produce evidence of exposure to Met-Pro’s products. In those cases where evidence has been produced, the Company’s experience has been that the exposure levels are low and the Company’s position has been that its products were not a cause of death, injury or loss. The Company has been dismissed from or settled a large

number of these cases. Cumulative settlement payments from 2002 through September 30, 2016 for cases involving asbestos-related claims were \$1.1 million, of which together with all legal fees other than corporate counsel expenses; \$1.0 million have been paid by the Company's insurers. The average cost per settled claim, excluding legal fees, was approximately \$30,000.

Based upon the most recent information available to the Company regarding such claims, there were a total of 217 cases pending against the Company as of September 30, 2016 (with Connecticut, New York, Pennsylvania and West Virginia having the largest number of cases), as compared with 221 cases that were pending as of December 31, 2015. During the nine months ended September 30, 2016, 55 new cases were filed against the Company, and the Company was dismissed from 56 cases and settled 3 cases. Most of the pending cases have not advanced beyond the early stages of discovery, although a number of cases are on schedules leading to, or are scheduled for trial. The Company believes that its insurance coverage is adequate for the cases currently pending against the Company and for the foreseeable future, assuming a continuation of the current volume, nature of cases and settlement amounts. However, the Company has no control over the number and nature of cases that are filed against it, nor as to the financial health of its insurers or their position as to coverage. The Company also presently believes that none of the pending cases will have a material adverse impact upon the Company's results of operations, liquidity or financial condition.

## Valero

One of our subsidiaries, Fisher-Klosterman, Inc. (“FKI”), was a defendant in a products liability lawsuit filed in Harris County, Texas on August 23, 2010 by three Valero refining companies. The plaintiffs claimed that FKI (and its co-Defendants) used an allegedly defective refractory material included in cyclones it supplied to Valero that caused damages to refineries they own and operate. Plaintiffs claimed to have suffered property damages, including catalyst loss, regenerator repair costs, replacement part costs, damage to other property and business interruption loss. During the third quarter of 2014, the Company reached a settlement with the plaintiffs for \$0.5 million and, accordingly, recorded a corresponding charge to operations. In addition, the Company reached an agreement with a supplier to recover \$0.2 million related to this matter. The recovery was also recorded during the third quarter of 2014. The Company’s insurer, who had paid for the legal defense in this matter, initiated a new case in the Southern District of Ohio against the Company in October 2014 seeking, among other things, recoupment of past legal costs paid. The Southern District of Ohio subsequently ruled in April 2016 that the Company’s insurer did have a duty to defend the Company. The Company is vigorously disputing this claim, including the pursuit of counterclaims against the insurer, and obtained a preliminary ruling that its insurer was obligated to provide the Company a defense for the Valero litigation.

## PMFG shareholder lawsuits

Since the public announcement of the proposed merger on May 4, 2015, CECO, Merger Sub I, Merger Sub II, PMFG and the members of the PMFG board of directors have been named as defendants in three lawsuits related to the acquisition, which were filed by alleged stockholders of PMFG on May 17, 2015, June 29, 2015 and July 17, 2015. The first filed lawsuit, which is a derivative action that also purports to assert class claims, was filed in the District Court of Dallas County, Texas (the “Texas Lawsuit”). The second and third filed lawsuits, which are class actions, were filed in the Court of Chancery of the State of Delaware and have now been consolidated into a single action (the “Delaware Lawsuit,” and collectively with the Texas Lawsuit, the “Lawsuits”). In the Lawsuits, the plaintiffs generally allege that the merger failed to properly value PMFG, that the individual defendants breached their fiduciary duties in approving the related merger agreement, and that those breaches were aided and abetted by CECO, Merger Sub I and Merger Sub II.

In the Lawsuits, the plaintiffs allege, among other things, (a) that the PMFG board of directors breached its fiduciary duties by agreeing to the merger for inadequate consideration and pursuant to a tainted process by (1) agreeing to lock up the merger with deal protection devices that, notwithstanding the ability of PMFG to solicit actively alternative transactions, prevent other bidders from making a successful competing offer for PMFG, (2) participating in a transaction where the loyalties of the PMFG board of directors and management are divided, and (3) relying on financial and legal advisors who plaintiffs allege were conflicted; (b) that those breaches of fiduciary duties were aided and abetted by CECO, Merger Sub I, Merger Sub II and PMFG, and (c) that the disclosure provided in the registration statement filed by CECO on June 9, 2015 was inadequate in a number of respects.

In the Lawsuits, the plaintiffs sought, among other things, (a) to enjoin the defendants from completing the merger on the agreed-upon terms, (b) rescission, to the extent already implemented, of the merger agreement or any of the terms therein, and (c) costs and disbursements and attorneys’ and experts’ fees, as well as other equitable relief as the courts deem proper.

Effective as of August 23, 2015, PMFG and the other defendants entered a memorandum of understanding with the plaintiffs in the Delaware Lawsuit regarding the settlement of the Delaware Lawsuit. In connection with this memorandum of understanding, PMFG agreed to make certain additional disclosures to PMFG’s stockholders in order to supplement those contained in the joint proxy statement/prospectus. After PMFG enters into a definitive agreement with the plaintiffs in the Delaware Lawsuit, the proposed settlement will be subject to notice to the class, Court

approval, and, if the Court approves the settlement, the settlement, as outlined in the memorandum of understanding, will resolve all of the claims that were or could have been brought in the Delaware Lawsuit, including all claims relating to the decision to enter into the Mergers, entry of the Merger Agreement and any disclosure made in connection therewith including any such claims against CECO, Merger Sub I or Merger Sub II, but did not affect any stockholder's rights to pursue appraisal rights. It is expected that the resolution of the Delaware Lawsuit will also resolve the Texas Lawsuit, which was stayed voluntarily by the plaintiff, but placed on Texas court's two-week docket for a non-jury trial on August 15, 2016. On May 11, 2016, the Court entered an order preliminarily approving the proposed settlement and setting a hearing on July 13, 2016 during which it would consider whether to enter an order granting final approval of the proposed settlement.

On September 1, 2016, the plaintiffs withdrew from the settlement and filed a notice of dismissal of their claims with prejudice. On September 2, 2016, the Court granted plaintiffs' request and dismissed their claims with prejudice. The Court retained jurisdiction to consider any applications for "mootness" based attorneys' fees and expenses from plaintiffs and/or the counsel for the objector. Briefing on the attorneys' fees request is ongoing.

## Summary

The Company is also a party to routine contract and employment-related litigation matters and routine audits of state and local tax returns arising in the ordinary course of its business.

The final outcome and impact of open matters, and related claims and investigations that may be brought in the future, are subject to many variables, and cannot be predicted. In accordance with ASC 450, "Contingencies," and related guidance, we record reserves for estimated losses relating to claims and lawsuits when available information indicates that a loss is probable and the amount of the loss, or range of loss, can be reasonably estimated. The Company expenses legal costs as they are incurred.

We are not aware of pending claims or assessments, other than as described above, which may have a material adverse impact on our liquidity, financial position, results of operations, or cash flows.

## 17. Acquisition PMFG

On September 3, 2015, the Company completed its acquisition of 100% of PMFG's outstanding common stock for a purchase price of \$136.7 million. PMFG's shareholders had the option to elect to exchange each share of PMFG common stock for either (i) \$6.85 in cash, without interest, or (ii) shares of the Company's common stock valued at \$6.85, based on the volume weighted average trading price of the Company's common stock for the 15-trading day period ending on September 2, 2015, the last trading day before the closing of the acquisition, subject to a collar so that there was a maximum exchange ratio of 0.6456 shares of the Company's common stock for each share of PMFG common stock and a minimum exchange ratio of 0.5282 shares of the Company's common stock for each share of PMFG common stock, subject to certain exceptions and with overall elections subject to proration.

Approximately 44.5% of the shares of PMFG common stock converted into the right to receive the \$6.85 cash consideration, for an approximate total of \$64.6 million. The Company's common stock trading price for the 15-trading day period was \$9.6655. As a result, each of the remaining shares of PMFG common stock converted into the right to receive 0.6456 shares of Company common stock, or an approximate total of 7,602,166 shares of Company common stock in aggregate.

In accordance with the proration and reallocation provisions of the merger agreement, because the \$6.85 per share cash consideration was oversubscribed by PMFG shareholders prior to the election deadline, (a) each PMFG share for which a valid stock election was made or for which no valid cash or stock election was made was automatically cancelled and converted into the right to receive the stock consideration and (b) each PMFG shareholder of record that made a valid cash election by the deadline received (i) the cash consideration for approximately 58.05% of such holder's PMFG shares for which a valid cash election was made and (ii) the stock consideration for approximately 41.95% of such holder's PMFG shares for which a valid cash election was made. The value of stock recorded for purchase accounting was \$72.1 million, which equates to approximately \$9.49 per share.

PMFG is a global provider of engineered equipment for the abatement of air pollution, the separation and filtration of contaminants from gases and liquids, and industrial noise control equipment, which complements our Energy Segment businesses.

As a result of the PMFG acquisition, the Company acquired a 60% equity investment in Peerless Propulsys that entitled the Company to 80% of Peerless Propulsys's earnings. In prior periods, the noncontrolling interest of Peerless Propulsys was reported as a separate component on the Condensed Consolidated Balance Sheets. During the third quarter, the Company entered into an agreement with the noncontrolling owner of Peerless Propulsys and issued a promissory note in the amount of \$5.3 million due on July 11, 2019 in exchange for 100% ownership in the equity and earnings of Peerless Propulsys. The minority interest had a carrying value of \$4.1 million on July 11, 2016, after the purchase accounting adjustment noted in the following paragraph, compared to the purchase price of \$5.3 million. Since the Company already had control over the equity investment, the excess paid of \$1.2 million was recorded as a debit to additional paid in capital. The interest rate on the note payable is 1.50%, which approximates the market rate given the short term duration of the note payable. All of the borrowers' assets are pledged to secure this agreement. As of September 30, 2016, \$5.3 million of this note payable was outstanding. The note is payable at the earlier of July 11, 2019 or thirty days subsequent to the sale of building and land that the Company owns in China. As the Company intends to sell this building and land within one year of September 30, 2016, this note payable is currently classified as a current liability in the Condensed Consolidated Balance Sheets as of September 30, 2016. In

conjunction with the entering into the agreement to acquire the noncontrolling interest of Peerless Propulsys, the Company listed the land and building as assets held for sale in the Condensed Consolidated Balance Sheet as of September 30, 2016.

Additionally, during the third quarter of 2016, in concluding purchase accounting, the fair value of the building and land owned by Peerless Propulsys and the minority interest was finalized. The fair value of the building and land was determined to be approximately \$6.2 million, which resulted in a reduction of \$5.2 million to the value of the building and land acquired as of the date of closing. The corresponding fair value of the noncontrolling interest was then determined to be approximately \$4.2 million, which resulted in a reduction of \$1.8 million to the value of the noncontrolling interest acquired as of the date of closing.

The following table summarizes the approximate fair values of the assets acquired and liabilities assumed at the date of closing after the Company finalized purchase accounting during 2016.

(Table only in thousands)

Current assets (including cash of \$27,100)	\$92,293
Property and equipment	24,787
Other assets	953
Assets held for sale (a)	950
Deferred income tax asset	—
Goodwill	59,860
Intangible – finite life	29,940
Intangible – indefinite life	10,280
Total assets acquired	219,063
Current liabilities assumed	(73,364 )
Deferred income tax liability	(800 )
Long term liabilities assumed	(3,961 )
Noncontrolling interest	(4,212 )
Net assets acquired	\$ 136,726

(a) The assets held for sale consist primarily of real property, and are valued at the estimated proceeds less cost to sell.

The Company has not recorded a gain or loss on the classification of the subject assets to be held for sale. The

Company expects to complete the sale of the subject assets within the next twelve months.

For the three months ended September 30, 2016, PMFG accounted for \$23.9 million of revenue and \$3.7 million of pre-tax income included in the Company's results. For the nine months ended September 30, 2016, PMFG accounted for \$73.8 million of revenue and \$8.6 million of pre-tax income included in the Company's results.

The fair values of the assets acquired and liabilities assumed, and the related tax balances were finalized during the quarter ended September 30, 2016.

The following unaudited pro forma information represents the Company's results of operations as if the PMFG acquisition had occurred as of January 1, 2014:

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	Three Months Ended	Nine Months Ended
(Table only in thousands, except per share data)	September 30, 2015	September 30, 2015
Net sales	\$ 119,070	\$ 359,480
Net loss	(18,342 )	(26,489 )
Loss per share:		
Basic	\$ (0.54 )	\$ (0.76 )
Diluted	\$ (0.54 )	\$ (0.76 )

The pro forma results have been prepared for informational purposes only and include adjustments to amortize acquired intangible assets with finite life, reflect foregone interest income on cash paid for the acquisitions, reflect additional interest expense on debt used to fund the acquisitions, and to record the income tax consequences of the pro forma adjustments. Included in the pro forma results are acquisition related expenses of \$15.5 million and \$16.8 million for the three-month and nine-month periods ended September 30, 2015 respectively. Shares used to calculate the basic and diluted loss per share were adjusted to reflect the additional shares of common stock issued to fund a portion of the acquisition price. These pro forma



results do not purport to be indicative of the results of operations that would have occurred had the purchases been made as of the beginning of the periods presented or of the results of operations that may occur in the future.

Acquisition and integration expenses on the Condensed Consolidated Statements of Operations are related to acquisition activities, which include retention, legal, accounting, banking, and other expenses.

## 18. Business Segment Information

The Company's operations are organized and reviewed by management along its product lines and presented in three reportable segments.

### Environmental Segment

Our Environmental segment provides the design and manufacture of product recovery and air pollution control technologies that enable our customers to meet compliance targets for toxic emissions, fumes, volatile organic compounds, process and industrial odors. These products and solutions include chemical and biological scrubbers, fabric filters and cartridge collectors, thermal and catalytic oxidation systems, cyclones, separators, gas absorbers and industrial ventilation systems. This segment also provides component parts for industrial air systems and provides cost effective alternatives to traditional duct components, as well as custom metal engineered fabrication services. These products and services are applicable to a wide variety of industries.

### Energy Segment

Our Energy segment provides customized solutions for the power and petrochemical industry. This includes gas turbine exhaust systems, dampers and diverters, gas and liquid separation and filtration equipment, selective catalytic reduction ("SCR") and selective non-catalytic reduction ("SNCR") systems, acoustical components and silencers, secondary separators (nuclear plant reactor vessels) and expansion joints, the design and manufacture of technologies for flue gas and diverter dampers, non-metallic expansion joints, natural gas turbine exhaust systems, and silencer and precipitator applications, primarily for coal-fired and natural gas power plants, refining, oil production and petrochemical processing, as well as a variety of other industries.

### Fluid Handling and Filtration Segment

Our Fluid Handling and Filtration ("FHF") segment provides the design and manufacture of high quality pump, filtration and fume exhaust solutions. This includes centrifugal pumps for corrosive, abrasive and high temperature liquids, filter products for air and liquid filtration, precious metal recovery systems, carbonate precipitators, and technologically advanced air movement and exhaust systems. These products are applicable to a wide variety of industries, particularly the aquarium/aquaculture, plating and metal finishing, food and beverage, chemical/petrochemical, wastewater treatment, desalination and pharmaceutical markets.

The accounting policies of the reporting segments are the same as those described in the summary of significant accounting policies in the Company's Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC. Interest income and expense are not included in the measure of segment profit reviewed by management. Income taxes are also not included in the measure of segment operating profit reviewed by management. The operating results of the segments are reviewed through to the "Income from operations" line on the Condensed Consolidated Statements of Operations.

The financial segment information is presented in the following tables:

(dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net Sales (less intra-, inter-segment sales)				
Environmental Segment	\$36,606	\$40,644	\$119,939	\$124,158
Energy Segment	50,259	40,014	151,058	91,666
Fluid Handling and Filtration Segment	14,866	17,136	46,874	50,075
Corporate and Other <sup>(1)</sup>	(135 )	436	(842 )	277
Net sales	\$101,596	\$98,230	\$317,029	\$266,176

<sup>(1)</sup>Includes adjustment for revenue on intercompany jobs.

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(dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
<b>Income (loss) from Operations</b>				
Environmental Segment	\$5,459	\$5,225	\$16,324	\$14,383
Energy Segment	8,502	(1,082 )	20,065	(447 )
Fluid Handling and Filtration Segment	3,109	4,011	9,507	11,398
Corporate and Other <sup>(2)</sup>	(6,520 )	(11,170)	(20,058)	(20,061)
Eliminations	(51 )	822	(971 )	-
<b>Income (loss) from operations</b>	<b>\$10,499</b>	<b>\$(2,194 )</b>	<b>\$24,867</b>	<b>\$5,273</b>

<sup>(2)</sup>Includes corporate compensation, professional services, information technology, acquisition and integration expenses, and other general and administrative corporate expenses.

(dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
<b>Property and Equipment Additions</b>				
Environmental Segment	\$4	\$49	\$232	\$130
Energy Segment	225	66	529	245
Fluid Handling and Filtration Segment <sup>(3)</sup>	1,118	65	4,428	133
Corporate and Other	1	5	7	18
<b>Property and equipment additions</b>	<b>\$1,348</b>	<b>\$185</b>	<b>\$5,196</b>	<b>\$526</b>

<sup>(3)</sup>Includes non-cash additions of \$1,089 and \$4,385 for property, plant, and equipment acquired under capital leases during the three months ended September 30, 2016 and nine months ended September 30, 2016, respectively. See Note 15 for further detail.

(dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
<b>Depreciation and Amortization</b>				
Environmental Segment	\$994	\$1,092	\$2,868	\$3,349
Energy Segment	2,341	1,526	8,082	2,957
Fluid Handling and Filtration Segment	1,321	1,586	3,969	4,772
Corporate and Other	33	70	98	139
<b>Depreciation and Amortization</b>	<b>\$4,689</b>	<b>\$4,274</b>	<b>\$15,017</b>	<b>\$11,217</b>

	September 30, December 31,	
(dollars in thousands)	2016	2015
<b>Identifiable Assets</b>		
Environmental Segment	\$ 122,350	\$ 135,171
Energy Segment	263,059	283,002
Fluid Handling and Filtration Segment	155,143	161,394
Corporate and Other <sup>(4)</sup>	21,406	19,252
<b>Identifiable Assets</b>	<b>\$ 561,958</b>	<b>\$ 598,819</b>

<sup>(4)</sup>Corporate assets primarily consist of cash and income tax related assets.

	September 30, December 31,	
(dollars in thousands)	2016	2015
<b>Goodwill</b>		
Environmental Segment	\$ 55,031	\$ 55,031
Energy Segment	76,443	72,075
Fluid Handling and Filtration Segment	93,057	93,057
<b>Goodwill</b>	<b>\$ 224,531</b>	<b>\$ 220,163</b>

## Intra-segment and Inter-segment Revenues

The Company has multiple divisions that sell to each other within segments (intra-segment sales) and between segments (inter-segment sales) as indicated in the following tables:

	Three Months Ended September 30, 2016						
	Total	Intra-Segment	Less Inter-Segment Sales				Net Sales to
(dollars in thousands)	Sales	Sales	Environmental	Energy	FHF	Other	Customers
Net Sales							
Environmental Segment	\$38,454	\$(941 )	\$—	\$(878 )	\$(29)	\$—	\$ 36,606
Energy Segment	51,155	(874 )	(22 )	—	—	—	50,259
Fluid Handling and Filtration Segment	15,451	(313 )	(88 )	(184 )	—	—	14,866
Corporate and Other <sup>(5)</sup>	—	—	—	—	—	(135)	(135 )
Net Sales	\$105,060	\$(2,128 )	\$(110)	\$(1,062)	\$(29)	\$(135)	\$ 101,596

	Three Months Ended September 30, 2015						
	Total	Intra-Segment	Less Inter-Segment Sales				Net Sales to
(dollars in thousands)	Sales	Sales	Environmental	Energy	FHF	Other	Customers
Net Sales							
Environmental Segment	\$42,925	\$(1,928 )	\$—	\$(345 )	\$(8 )	\$—	\$ 40,644
Energy Segment	41,511	(1,490 )	(7 )	—	—	—	40,014
Fluid Handling and Filtration Segment	17,654	(424 )	(94 )	—	—	—	17,136
Corporate and Other <sup>(5)</sup>	—	—	—	—	—	436	436
Net Sales	\$102,090	\$(3,842 )	\$(101)	\$(345 )	\$(8 )	\$436	\$ 98,230

	Nine Months Ended September 30, 2016						
	Total	Intra-Segment	Less Inter-Segment Sales				Net Sales to
(dollars in thousands)	Sales	Sales	Environmental	Energy	FHF	Other	Customers
Net Sales							
Environmental Segment	\$126,029	\$(3,539 )	\$—	\$(2,345)	\$(206)	\$—	\$ 119,939
Energy Segment	153,476	(2,019 )	(399)	—	—	—	151,058

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Fluid Handling and Filtration Segment	48,508	(1,168 )	(282)	(184 )	—	—	46,874
Corporate and Other <sup>(5)</sup>	—	—	—	—	—	(842)	(842 )
Net Sales	\$328,013	\$(6,726 )	\$(681)	\$(2,529)	\$(206)	\$(842)	\$ 317,029

Nine Months Ended September 30, 2015

	Less Inter-Segment Sales						Net Sales to
	Intra-					Corp	Net Sales to
	Total	Segment				and	Outside
(dollars in thousands)	Sales	Sales	Environmental	Energy	FHF	Other	Customers
Net Sales							
Environmental Segment	\$130,315	\$(5,211 )	\$—	\$(938 )	\$(8 )	\$—	\$ 124,158
Energy Segment	96,037	(3,745 )	(626)	—	—	—	91,666
Fluid Handling and Filtration Segment	51,847	(1,575 )	(197)	—	—	—	50,075
Corporate and Other <sup>(5)</sup>	—	—	—	—	—	277	277
Net Sales	\$278,199	\$(10,531)	\$(823)	\$(938 )	\$(8 )	\$277	\$ 266,176

<sup>(5)</sup>Includes adjustment for revenue on intercompany jobs.

CECO ENVIRONMENTAL CORP. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

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

The Company's Condensed Consolidated Statements of Operations for the three-month and nine-month periods ended September 30, 2016 and 2015 reflect the consolidated operations of the Company and its subsidiaries.

We are a diversified global provider of leading engineered technologies to the environmental, energy, and fluid handling and filtration industrial segments, targeting specific niche-focused end markets through an attractive asset-light business model. We provide a wide spectrum of products and services including dampers & diverters, cyclonic technology, thermal oxidizers, separation and filtration systems, selective catalytic reduction ("SCR") and selective non-catalytic reduction ("SNCR") systems, scrubbers, dampers and silencers, exhaust systems, fluid handling equipment and plant engineered services and engineered design build fabrication. These products play a vital role in helping companies achieve exacting production standards, meeting increasing plant needs and stringent emissions control regulations around the globe. We believe that globally we serve the broadest range of markets and industries, including power, municipalities, chemical, industrial manufacturing, mid-stream pipeline natural gas transmission, refining, petrochemical, metals, minerals & mining companies, as well as hospitals and universities.

We are a global corporation with worldwide operations. As a global business, our operations are affected by worldwide, regional and industry-specific economic factors, as well as political factors, wherever we operate or do business. Our geographic and industry diversity, and the breadth of our product and services portfolios, have helped mitigate the impact of any one industry or the economy of any single country on our consolidated operating results.

We believe demand for our products is driven by the increasing demand for energy in both developed and emerging markets, coupled with the global trend towards increasingly restrictive environmental regulations. These trends should stimulate investment in new power generation facilities and related infrastructure, and in upgrading existing facilities.

With a shift to cleaner, more environmentally responsible power generation, power providers and industrial power consumers are building new facilities that use cleaner fuels, such as natural gas, nuclear technology and renewable resources. In developed markets, natural gas is increasingly becoming one of the energy sources of choice. We supply product offerings throughout the entire natural gas infrastructure value chain and believe the expansion of natural gas infrastructure will drive growth within our Energy segment and the global market for our SCR systems for natural-gas-fired power plants.

We believe there will be an increase in the level of pollution control capital expenditures driven by an elevated focus on environmental issues such as global warming and energy saving alternatives, as well as a U.S. government supported effort to reduce our dependence on foreign oil through the use of bio-fuels like ethanol and electrical energy generated by our abundant domestic supply of coal. We also feel that similar opportunities will continue to develop outside the United States. Much of our business is driven by various regulatory standards and guidelines governing air quality in and outside factories. Our Asia operation is positioned to benefit from the tightening of air pollution standards by China's Ministry of Environmental Protection.

We continue to focus on increasing revenues and profitability globally while continuing to strengthen and expand our presence domestically. Our operating strategy has historically involved horizontally expanding our scope of technology, products, and services through selective acquisitions and the formation of new business units that are then vertically integrated into our growing group of turnkey system providers. Our continuing focus will be on global growth, market coverage, and expansion of our Asia operations. Operational excellence, margin expansion, after-market recurring revenue growth, and safety leadership are also critical to our growth strategy.

#### Operations Overview

We operate under a “hub and spoke” business model in which executive management, finance, administrative and marketing staff serves as the hub while the sales channels serve as spokes. We use this model throughout our operations. This has provided us with certain efficiencies over a more decentralized model. The Company’s segment presidents manage its division managers who are responsible for successfully running their operations, that is, sales, gross margins, manufacturing, pricing, purchasing, safety, employee development and customer service excellence. The segment presidents work closely with our Chief Executive Officer on global growth strategies, operational excellence, and employee development. The headquarters (hub) focuses on enabling the core back-office key functions for scale and efficiency -- accounting, payroll, human resources/benefits, information technology, safety support, internal control over financial reporting, and administration. We have excellent organizational focus from headquarters



throughout our divisional businesses with clarity and minimal duplicative work streams. We are structured for growth and will do future bolt-on acquisitions.

Our three reportable segments are: the Environmental segment, which produces various types of product recovery and air pollution control technologies; the Energy segment, which produces customized solutions for the power and petrochemical industry; and the Fluid Handling and Filtration (“FHF”) segment, which produces high quality pump, filtration and fume exhaust solutions. It is through combining the efforts of some or all of these groups that we are able to offer complete turnkey systems to our customers and leverage operational efficiencies.

Our contracts are obtained either through competitive bidding or as a result of negotiations with our customers. Contract terms offered by us are generally dependent on the complexity and risk of the project as well as the resources that will be required to complete the project. Our focus is on increasing our operating margins as well as our gross margin percentage, which translates into higher net income.

Our cost of sales is principally driven by a number of factors, including material prices and labor cost and availability. Changes in these factors may have a material impact on our overall gross profit margins.

We break down costs of sales into five categories. They are:

• Labor—Our direct labor both in the shop and in the field;

• Material—Raw material that we buy to build our products;

• Equipment—Fans, motors, control panels and other equipment necessary for turnkey systems;

• Subcontracts—Electrical work, concrete work and other subcontracts necessary to produce our products; and

• Factory overhead—Costs of facilities and supervision wages necessary to produce our products.

In general, labor provides us the most flexibility in margin followed by material and equipment and subcontracts. Across our various product lines, the relative relationships of these factors change and cause variations in gross margin percentage. Material costs have also increased faster than labor costs, which also reduces gross margin percentage.

Selling and administrative expense principally includes sales payroll and related fringes, advertising and marketing expenditures as well as all corporate and administrative functions and other costs that support our operations. The majority of these expenses are fixed. We expect to leverage our fixed operating structure as we continue to grow our revenue.

#### Note Regarding Use of Non-GAAP Financial Measures

The Company’s unaudited condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). These GAAP financial statements include certain charges the Company believes are not indicative of its core operational performance.

As a result, the Company provides financial information in this MD&A that was not prepared in accordance with GAAP and should not be considered as an alternative to the information prepared in accordance with GAAP. The Company provides this supplemental non-GAAP financial information because the Company’s management utilizes it to evaluate its ongoing financial performance and the Company believes it provides greater transparency to investors as supplemental information to its GAAP results.

The Company has provided the non-GAAP financial measure of non-GAAP operating income and margin as a result of items that the Company believes are not indicative of its ongoing operations. These include charges associated with the Company’s acquisition and integration of recent acquisitions and the items described below in “Consolidated

Results.” The Company believes that evaluation of its financial performance compared with prior and future periods can be enhanced by a presentation of results that exclude the impact of these items. As a result of the Company’s recently completed acquisitions, the Company has incurred and expects to continue to incur substantial charges associated with the acquisition and integration of these companies. See Note 17 to the unaudited condensed consolidated financial statements for further information on acquisitions.

## Results of Operations

## Consolidated Results

Our Condensed Consolidated Statements of Operations for the three-month and nine-month periods ended September 30, 2016 and 2015 are as follows:

(dollars in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	\$101.6	\$98.2	\$317.0	\$266.2
Cost of sales	67.9	67.4	217.8	187.8
Gross profit	\$33.7	\$30.8	\$99.2	\$78.4
Percent of sales	33.2 %	31.4 %	31.3 %	29.5 %
Selling and administrative expenses	\$19.5	\$18.0	\$60.6	\$46.1
Percent of sales	19.2 %	18.3 %	19.1 %	17.3 %
Acquisition and integration expenses	\$0.2	\$5.7	\$0.5	\$7.0
Percent of sales	0.2 %	5.8 %	0.2 %	2.6 %
Amortization and earn-out expenses	\$3.5	\$9.3	\$13.2	\$20.0
Percent of sales	3.4 %	9.5 %	4.2 %	7.5 %
Operating income (loss)	\$10.5	\$(2.2)	\$24.9	\$5.3
Operating margin	10.3 %	(2.2 %)	7.9 %	2.0 %

To compare operating performance between the three-month and nine-month periods ended September 30, 2016 and 2015, the Company has adjusted GAAP operating income (loss) to exclude (1) acquisition and integration related expenses, including legal, accounting, and banking expenses, (2) amortization and contingent acquisition expenses, including amortization of acquisition related intangibles, retention, severance, and earn-out expenses, (3) gain on insurance settlement and (4) inventory valuation and plant, property and equipment valuation adjustments related to acquisitions. See "Note Regarding Use of Non-GAAP Financial Measures" above. The following table presents the reconciliation of GAAP operating income (loss) and GAAP operating margin to non-GAAP operating income and non-GAAP operating margin:

(dollars in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Operating income as reported in accordance with GAAP	\$10.5	\$(2.2)	\$24.9	\$5.3
Operating margin in accordance with GAAP	10.3 %	(2.2) %	7.9 %	2.0 %
Inventory valuation adjustment	—	—	0.1	—
Plant, property and equipment valuation adjustment	0.2	0.2	0.5	0.5
Gain on insurance settlement	—	—	(1.0)	—

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Acquisition and integration expenses	0.2	5.7	0.5	7.0
Amortization and earn-out expenses	3.5	9.3	13.2	20.0
Non-GAAP operating income	\$14.4	\$13.0	\$38.2	\$32.8
Non-GAAP operating margin	14.2%	13.2%	12.1%	12.3%

Consolidated sales for the third quarter of 2016 increased \$3.4 million, or 3.5%, to \$101.6 million compared with \$98.2 million in the third quarter of 2015. The increase is primarily attributable to PMFG, acquired in September 2015, which contributed \$23.9 million in sales for the third quarter of 2016 and \$12.6 million in sales for the third quarter of 2015. This increase in sales is partially offset by decreases in sales for the Environmental Segment and Fluid Handling and Filtration Segment during the third quarter by \$4.0 million and \$2.2 million, respectively.

Consolidated sales for the first nine months of 2016 increased \$50.8 or 19.1% to \$317.0 million compared with \$266.2 million in the first nine months of 2015. The increase is primarily attributable to PMFG, acquired in September 2015, which contributed \$73.8 million in sales for the first nine months of 2016 and \$12.6 million in sales for the first nine months of 2015. This increase in sales is partially offset by decreases in sales for the Environmental Segment and FHF Segment during the first nine months of the year by \$4.3 million and \$3.2 million, respectively.

Gross profit increased \$2.9 million, or 9.4%, to \$33.7 million in the third quarter of 2016 compared with \$30.8 million in the same period of 2015. The increase is primarily attributable to PMFG, which contributed \$8.4 million and \$4.5 million in gross profit for the third quarter of 2016 and 2015, respectively. Gross profit as a percentage of sales was 33.2% in the third quarter of 2016 compared with 31.4% in the third quarter of 2015.

Gross profit increased \$20.8 million, or 26.5%, to \$99.2 million in the first nine months of 2016 compared with \$78.4 million in the same period of 2015. The increase is primarily attributable to PMFG, which contributed \$26.2 million and \$4.5 million in gross profit for the first nine months of 2016 and 2015, respectively. Gross profit as a percentage of sales was 31.3% in the first nine months of 2016 compared with 29.5% in the first nine months of 2015. The higher gross profit margin in the first nine months of 2016 was primarily due to higher than average margins earned throughout the year by PMFG.

Orders booked were \$96.2 million during the third quarter of 2016 and \$325.1 million during the first nine months of 2016 as compared with \$88.8 million during the third quarter of 2015 and \$257.2 million during the first nine months of 2015. The increase in the 2016 periods was primarily due to the PMFG acquisition, which represented \$19.4 million and \$7.1 million of total bookings in the third quarter of 2016 and 2015, respectively. PMFG represented \$72.3 million and \$7.1 million of total bookings in the first nine months of 2016 and 2015, respectively.

Selling and administrative expenses increased \$1.5 million to \$19.5 million for the third quarter of 2016 compared with \$18.0 million for the third quarter of 2015. The increase is primarily attributable to incremental selling and administrative expenses from the PMFG acquisition. The increase is partially offset by the Company recording a gain of \$0.6 million during the third quarter of 2016 related to a warranty settlement received from an external service provider of the Company. Additionally, selling and administrative expenses increased as a percentage of sales from 18.3% in the third quarter of 2015 compared with 19.2% in the third quarter of 2016.

Selling and administrative expenses increased \$14.5 to \$60.6 million for the first nine months of 2016 compared with \$46.1 for the first nine months of 2015. The increase is primarily attributable to incremental selling and administrative expenses from the PMFG acquisition. The increase is partially offset by the Company recording gains of \$1.6 million during the first nine months of 2016, which consisted of \$1.0 million related to a life insurance settlement and \$0.6 million related to a warranty settlement received from an external service provider of the Company. Selling and administrative expenses increased as a percentage of sales from 17.3% in the first nine months of 2015 compared with 19.1% in the first nine months of 2016.

Acquisition and integration expenses were \$0.2 million and \$5.7 million during the third quarter of 2016 and 2015, respectively, and \$0.5 million and \$7.0 million during the first nine months of 2016 and 2015, respectively. The decrease in acquisition and integration expenses was primarily due to costs incurred as a result of the PMFG acquisition which occurred during the third quarter of 2015.

Amortization and earn-out expense was \$3.5 million for the third quarter of 2016 compared with \$9.3 million for the third quarter of 2015. The decrease was primarily attributable to earn-out adjustments related to increased expense in the third quarter of 2015 for Zhongli Industrial Technology Co. Ltd. (“Zhongli”) that was partially offset by a \$0.5 million gain related to a reduction of the earn-out for SAT Technology, Inc. (“SAT”). Included in the third quarter 2015 expense was \$5.4 million related to the fair value adjustment of the Zhongli earn-out during the period due to higher than expected operational profit at Zhongli after the acquisition.

Amortization and earn-out expense was \$13.2 million for the first nine months of 2016 compared with \$20.0 million for the first nine months of 2015. The decrease was primarily attributable to earn-out adjustments related to the Zhongli acquisition that was recorded in 2015. Included in the first nine months of 2015 expense was \$9.9 million related to the fair value adjustment of the Zhongli earn-out during this period due to higher than expected operational

profit at Zhongli after the acquisition. These expense reductions were partially offset by increased amortization expense incurred due to the PMFG acquisition.

Operating income increased \$12.7 million to \$10.5 million in the third quarter of 2016 compared with a \$2.2 million loss during the third quarter of 2015. The Company achieved higher gross margins, lower acquisition and integration expenses, and lower amortization and earn-out expenses during the third quarter of 2016, which resulted in an increase in operating profit. PMFG contributed \$3.7 million and \$1.5 million for the third quarter of 2016 and 2015, respectively.

Operating income increased \$19.6 million to \$24.9 million in the first nine months of 2016 compared with \$5.3 million during the third quarter of 2015. The Company achieved higher gross margins, lower acquisition and integration expenses, and lower amortization and earn-out expenses during the first nine months of 2016, which resulted in an increase in operating profit. PMFG contributed \$8.2 million and \$1.5 million for the first nine months of 2016 and 2015, respectively.

Non-GAAP operating income was \$14.4 million for the third quarter of 2016 compared with \$13.0 million for the third quarter of 2015. The increase is primarily due to the increases from PMFG as described above.

Non-GAAP operating income was \$38.2 million for the first nine months of 2016 compared with \$32.8 million for the first nine months of 2015. The increase is primarily due to the increases from PMFG as described above.

Other income/expense, net was less than \$0.1 million in the third quarter of 2016 compared with \$0.3 million of expense in the third quarter of 2015. During the third quarter of 2016, the net amount was due to \$0.2 million of income from the impact of the strengthening of the Euro on an intercompany loan with a foreign subsidiary, and net foreign currency exchange losses from normal business operations of \$0.2 million. During the third quarter of 2015, the net \$0.3 million of expense was due primarily to net foreign currency exchange losses from business operations of \$0.6 million, partially offset by the effect of the strengthening of the Euro on an intercompany loan with a foreign subsidiary.

Other income/expense, net was \$0.4 million of income in the first nine months of 2016 compared with \$1.5 million of expense in the first nine months of 2015. During the first nine months of 2016, the net \$0.4 million of income was due to \$0.6 million of income from the impact of the strengthening of the Euro on an intercompany loan with a foreign subsidiary, and net foreign currency exchange gains from normal business operations of \$0.3 million, partially offset by a \$0.5 million loss on our interest rate swap prior to being designated as an effective hedge. During the first nine months of 2015, the net \$1.5 million of expense was due primarily the effect of the weakening of the Euro on an intercompany loan with a foreign subsidiary, which resulted in \$1.7 million of expense during the first nine months of 2015. This expense was offset by net foreign currency exchange gains from normal business operations of \$0.2 million.

Interest expense increased to \$1.9 million in the third quarter of 2016 from \$1.7 million in the third quarter of 2015. The increase is due primarily to borrowings incurred in connection with the PMFG acquisition, which were outstanding for a longer period during the third quarter of 2016.

Interest expense increased to \$6.0 million in the first nine months of 2016 from \$3.8 million in the first nine months of 2015. The increase is due primarily to borrowings incurred in connection with the PMFG acquisition.

Income tax expense was \$2.8 million for the third quarter of 2016 compared with \$0.6 million for the same quarter of 2015. The effective income tax rate for the third quarter of 2016 was 32.3% compared with a negative rate for the comparable period of 2015. Income tax expense was \$6.3 million for the first nine months of 2016 compared with \$2.5 million for the same period of 2015. The effective income tax rate for the first nine months of 2016 was 33.0% compared with a negative rate for the comparable period of 2015. This rate change for the three and nine month periods is due primarily to an increase in income before taxes and a decrease in permanent differences related to non-deductible acquisition and earn-out expenses partially offset by a decrease in an income tax reserve. Our effective tax rate is affected by certain permanent differences, including non-deductible incentive stock-based compensation and acquisition and earn-out related expenses, certain income tax reserves/deferrals, impact of foreign rate differences and decreased tax rates in certain foreign jurisdictions.

#### Business Segments

The Company's operations are organized and reviewed by management along its product lines and presented in three reportable segments. The results of the segments are reviewed through to the "Income from operations" line on the unaudited Condensed Consolidated Statements of Operations.

Three Months Ended	Nine Months Ended
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(dollars in thousands)	September 30,		September 30,	
	2016	2015	2016	2015
Net Sales (less intra-, inter-segment sales)				
Environmental Segment	\$36,606	\$40,644	\$119,939	\$124,158
Energy Segment	50,259	40,014	151,058	91,666
Fluid Handling and Filtration Segment	14,866	17,136	46,874	50,075
Corporate and Other <sup>(1)</sup>	(135 )	436	(842 )	277
Net sales	\$101,596	\$98,230	\$317,029	\$266,176

<sup>(1)</sup> Includes adjustment for revenue on intercompany jobs.

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(dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Income (loss) from Operations				
Environmental Segment	\$5,459	\$5,225	\$16,324	\$14,383
Energy Segment	8,502	(1,082 )	20,065	(447 )
Fluid Handling and Filtration Segment	3,109	4,011	9,507	11,398
Corporate and Other <sup>(2)</sup>	(6,520 )	(11,170)	(20,058)	(20,061)
Eliminations	(51 )	822	(971 )	-
Income (loss) from operations	\$10,499	\$(2,194 )	\$24,867	\$5,273

<sup>(2)</sup> Includes corporate compensation, professional services, information technology, acquisition and integration expenses, and other general and administrative corporate expenses.

#### Environmental Segment

Our Environmental Segment net sales decreased \$4.0 million to \$36.6 million in the third quarter of 2016 compared with \$40.6 million in the same period of 2015. The decrease is due primarily to decreased volume of installation and fabrication of scrubbers, mist eliminators, and aeration tower product lines.

Our Environmental Segment net sales decreased \$4.3 million to \$119.9 million in the first nine months of 2016 compared with \$124.2 million in the same period of 2015. The decrease is due primarily to volume decreases for our scrubber, mist eliminator, and aeration tower product lines, partially offset by an increased volume of installation and fabrication of custom engineered industrial HVAC systems.

Operating income for the Environmental Segment increased \$0.3 million to \$5.5 million in the third quarter of 2016 from \$5.2 million in the same period of 2015. This increase was primarily due to the Environmental Segment achieving higher gross margins on decreased sales and a reduction in selling and administrative expenses during the third quarter of 2016 attributable to a more favorable project mix.

Operating income for the Environmental Segment increased \$1.9 million to \$16.3 million in the first nine months of 2016 from \$14.4 million in the same period of 2015. This increase was primarily due to \$0.5 million of income as a result of an adjustment to the fair value of the earn-out from our SAT Technology Inc. acquisition, as well as higher gross margins and decreased selling and administrative expenses attributable to a more favorable project mix during the first nine months of 2016.

#### Energy Segment

Our Energy Segment net sales increased \$10.3 million to \$50.3 million in the third quarter of 2016 compared with \$40.0 million in the same period of 2015. The increase is primarily attributable to PMFG, acquired in September 2015, which contributed \$23.9 million in sales for the third quarter of 2016 and \$12.6 million in sales for the third quarter of 2015.

Our Energy Segment net sales increased \$59.4 million to \$151.1 million in the first nine months of 2016 compared with \$91.7 million in the same period of 2015. The increase is primarily attributable to PMFG, acquired in September

2015, which contributed \$73.8 million in sales for the first nine months of 2016 and \$12.6 million in sales for the first nine months of 2015.

Operating income for the Energy Segment increased \$9.6 million to \$8.5 million in the third quarter of 2016 compared with \$(1.1) million loss in the third quarter of 2015. The increase is partially attributable to PMFG, which contributed \$3.7 million and \$1.8 million for the third quarter of 2016 and 2015, respectively. Included in the third quarter 2015 expense was \$5.4 million related to the fair value adjustment of the Zhongli earn-out during this period. Additionally, there was a general improvement in gross margin percentages within the segment period over period.

Operating income for the Energy Segment increased \$20.5 million to \$20.1 million in the first nine months of 2016 compared with a \$(0.4) million loss in the same period of 2015. The increase is partially attributable to PMFG, which contributed \$8.2 million and \$1.8 million for the first nine months of 2016 and 2015, respectively. Included in the first nine months of 2015 expense was \$9.9 million related to the fair value adjustment of the Zhongli earn-out during this period. Additionally, there was a general improvement in gross margin percentages within the segment period over period.

### Fluid Handling and Filtration Segment

Our FHF Segment net sales decreased \$2.2 million to \$14.9 million in the third quarter of 2016 compared with \$17.1 million in the same period of 2015. The decrease is due to sales volume decline within the segment period over period, which is primarily attributable to a temporary weakness in the North American industrial market.

Our FHF Segment net sales decreased \$3.2 million to \$46.9 million in the first nine months of 2016 compared with \$50.1 million in the first nine months of 2015. The decrease is due to sales volume decline within the segment period over period, which is primarily attributable to a temporary weakness in the North American industrial market.

Operating income for FHF decreased \$0.9 million to \$3.1 million in the third quarter of 2016 compared with \$4.0 million in the third quarter of 2015. The decrease is due to sales volume decline described above.

Operating income for FHF decreased \$1.9 million to \$9.5 million in the first nine months of 2016 compared with \$11.4 million in the same period of 2015. The decrease is due to sales volume decline described above.

### Corporate and Other Segment

Operating loss for Corporate and Other Segment decreased \$4.7 million to \$6.5 million in the third quarter of 2016 compared with \$11.2 million in the same period of 2015. The decrease in the loss period over period is primarily attributable to decreased acquisition and integration expenses attributable to the Company's acquisition of PMFG, which is partially offset by incurring additional costs to support the additional revenues from PMFG's operations.

Operating loss for Corporate and Other Segment was relatively flat at \$20.1 million in the first nine months of 2016 compared with a \$20.1 million loss in the same period of 2015. The similar costs period over period is primarily attributable to decreased acquisition and integration expenses attributable to the Company's acquisition of PMFG, which is offset by incurring additional costs to support the additional revenues from PMFG's operations. These additional costs are partially offset by the recording of a gain of \$1.0 million during the first nine months of 2016 related to a life insurance settlement.

### Backlog

Backlog is a representation of the amount of revenue expected from complete performance of firm fixed-price contracts that have not been completed for products and services we expect to substantially deliver within the next twelve-month period. Our customers may have the right to cancel a given order, although historically cancellations have been rare. Our backlog as of September 30, 2016, was \$219.3 million compared with \$211.2 million as of December 31, 2015. Backlog is not defined by GAAP and our methodology for calculating backlog may not be consistent with methodologies used by other companies. 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 periods. 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.

### New Financial Accounting Pronouncements

For information regarding recent accounting pronouncements, see Note 2 to the unaudited condensed consolidated financial statements within Item 1 of this Quarterly Report on Form 10-Q.

## Liquidity and Capital Resources

Our principal sources of liquidity are cash flow from operations and available borrowings under our Credit Facility. Our principal uses of cash are operating costs, payment of principal and interest on our outstanding debt, dividends, working capital and other corporate requirements, including acquisitions.

The Company considers its level of cash on hand, borrowing capacity, current ratio and working capital levels to be its most important measures of short-term liquidity. For long-term liquidity indicators, the Company believes its ratio of long-term debt to equity and its historical levels of net cash flows from operating activities to be the most important measures.

At September 30, 2016, the Company had working capital of \$68.7 million, compared with \$80.3 million at December 31, 2015. The ratio of current assets to current liabilities was 1.47 to 1 as compared with a ratio of 1.54 to 1 at December 31, 2015. The \$11.6 million

decrease in working capital from December 31, 2015 to September 30, 2016 was primarily related to the net effect of increased cash and cash equivalents (\$7.6 million), an increase in assets held for sale (\$6.4 million) and an increase in prepaid expenses and other current assets (\$5.7 million), offset by a decrease in accounts receivable (\$14.4 million), an increase in billing in excess of costs and estimated earnings on uncompleted contracts (\$6.9 million), and a decrease in inventory (\$8.6 million). During the nine months ended September 30, 2016, the Company made a prepayment of \$23.3 million on the outstanding balance of the term loan, of which \$17.8 million was applied to the long-term portion of the debt balance, which caused a reduction in working capital. As described in Note 17, the Company entered into a note payable agreement for \$5.3 million during the nine months ended in September 30, 2016, which the Company believes will become due within a year. The Company has a strategy of aggressively managing working capital, including reduction of the accounts receivable days sales outstanding (DSO), and reduction of inventory levels, without reducing service to its customers.

At September 30, 2016 and December 31, 2015, cash and cash equivalents totaled \$41.8 million and \$34.2 million, respectively. As of September 30, 2016 and December 31, 2015, \$22.0 million and \$18.0 million, respectively, of our cash and cash equivalents were held by certain non-U.S. subsidiaries, as well as being denominated in foreign currencies.

Debt consisted of the following at September 30, 2016 and December 31, 2015:

	September 30,	December 31,
(Table only in thousands)	2016	2015
Outstanding borrowings under Credit Facility (defined in Note 8).		
Term loan payable in quarterly principal installments of \$2.1 million through September 2017, \$2.9 million through September 2018, and \$3.6 million thereafter with balance due upon maturity in September 2020.		
- Term loan	\$ 135,209	\$ 166,813
- U.S. Dollar revolving loans	—	8,000
- Unamortized debt discount and debt issuance costs	(3,426 )	(4,229 )
Total outstanding borrowings under Credit Facility	131,783	170,584
Outstanding borrowings (U.S. dollar equivalent)		
under China Facility	1,355	1,391
Outstanding borrowings (U.S. dollar equivalent)		
under Aarding Facility	309	5,326
Outstanding borrowings (U.S. dollar equivalent) under Euro-	—	27

denominated note payable to a bank, payable in quarterly installments of €25,000, plus interest, at a fixed rate of 3.82%, matured in January 2016. Collateralized by the

Heerenveen, Netherlands building.		
Total outstanding borrowings	133,447	177,328
Less: current portion	10,216	19,494
Total debt, less current portion	\$ 123,231	\$ 157,834

Credit Agreement

As of September 30, 2016 and December 31, 2015, the Company was in compliance with all related financial and other restrictive covenants under the Credit Facility.

See Note 8 to the condensed consolidated financial statements for further information on the Company's debt facilities.

Total unused credit availability under our existing Credit Facility and other non-U.S. credit facilities and agreements, exclusive of any potential asset base limitations, is as follows:

	September 30, December 31,	
(dollars in millions)	2016	2015
Credit Facility, U.S. Dollar revolving loans	\$ 60.5	\$ 60.5
Draw down	—	(8.0 )
Letters of credit open	(16.9 )	(15.4 )
Credit Facility, Multi-currency revolving facilities	19.5	19.5
Netherlands facilities (€13.0 million at September 30, 2016 and		
€14.0 million December 31, 2015 in U.S. Dollar equivalent)	14.6	15.3
Draw down	(0.3 )	(5.3 )
Letters of credit open	(2.4 )	(6.6 )
China facility	4.5	4.5
Draw down	(1.4 )	(1.4 )
Total unused credit availability	\$ 78.1	\$ 63.1
Amount available based on borrowing limitations	\$ 42.9	\$ 11.9

## Overview of Cash Flows and Liquidity

	For the nine months ended September 30,	
(dollars in thousands)	2016	2015
Net cash provided by (used in) operating activities	\$52,879	\$(8,866 )
Net cash used in investing activities	(510 )	(35,260)
Net cash provided by (used in) financing activities	(44,337)	56,778
Effect of exchange rate changes on cash and cash		
equivalents	(412 )	(51 )
Net increase (decrease) in cash	\$7,620	\$12,601

For the nine months ended September 30, 2016, \$52.9 million of cash was provided by operating activities compared with \$8.9 million used in operating activities in the prior year period. The \$61.8 million increase in cash flow from operating activities was partially due to an increase net income of \$15.4 million. Additionally, there were a few favorable net working capital items in the first nine months of 2016 compared with the same period in 2015. The incremental cash provided was comprised of \$31.9 million in accounts receivable, \$7.4 million in inventories, \$7.1 million in billings in excess of costs and estimated earnings on uncompleted contracts, and \$14.0 million in costs and estimated earnings in excess of billings on uncompleted contracts. The incremental cash used was comprised of \$12.4 million in accounts payable and accrued expenses and \$3.2 million in prepaid expenses and other current assets. The increase in cash provided by operating activities is primarily attributable to increased execution of managing working capital during the nine months ended September 30, 2016.

For the nine months ended September 30, 2016, net cash used in investing activities was \$0.5 million compared with net cash used in investing activities of \$35.3 million in the prior year period. In the current year period, cash used in investing activities was primarily the result of cash provided by the sale of property and equipment of \$0.3 million, offset by cash used for the acquisitions of property and equipment totaling \$0.8 million. In the prior year period, cash used in investing activities was primarily the result of cash used for additions to property and equipment of \$0.5

million and net cash paid for acquisition of \$37.1 million offset by the proceeds from sales of property and equipment, including assets held for sale, totaling \$2.4 million.

For the nine months ended September 30, 2016, net cash used in financing activities was \$44.3 million due principally to net term loan repayments of \$31.6 million, net payments on revolving credit facilities of \$13.1 million, earn-out payments of \$9.3 million, and \$6.7 million in dividends paid to common stockholders, which was partially offset by proceeds from sale-leaseback transactions of \$14.2 million. During the nine-month period ended September 30, 2016, the Company entered into three sale-leaseback transactions that caused the Company to recognize a sale-leaseback financing liability in the amount of \$5.0 million and capital lease obligations in the amount of \$8.7 million. In the prior year period, net cash provided by financing activities was \$56.8 million due principally to borrowings of long-term debt of \$170.0 million, offset by term loan repayments of \$102.0 million, financing fees paid of \$2.9 million, and \$5.7 million in dividends paid to common stockholders.

Our dividend policy and the payment of cash dividends under that policy are subject to the Board of Directors' continuing determination that the dividend policy and the declaration of dividends are in the best interest of the Company's stockholders. Future dividends and the dividend policy may be changed or cancelled at the Company's discretion at any time. Payment of dividends is also subject to the continuing compliance with our financial covenants under our Credit Facility.

When we undertake large jobs, our working capital objective is to make these projects self-funding. We work to achieve this by obtaining initial down payments, progress billing contracts, when possible, utilizing extended payment terms from material suppliers,



and paying sub-contractors after payment from our customers, which is an industry practice. Our investment in net working capital is funded by cash flow from operations and by our revolving line of credit.

### Critical Accounting Policies and Estimates

Management's discussion and analysis of the Company's financial condition and results of operations are based upon the Company's condensed consolidated financial statements. The preparation of these financial statements requires management to make estimates and assumptions about future events. These estimates and the underlying assumptions affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities and reported amounts of revenues and expenses. Such estimates include revenue recognition, the valuation of trade receivables, inventories, goodwill, intangible assets, other long-lived assets, legal contingencies, earnout liabilities, guarantee obligations and assumptions used in the calculation of income taxes, assumptions used in business combination accounting and related balances, and pension and post-retirement benefits, among others. These estimates and assumptions are based on management's best estimates and judgment. Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors. Management monitors the economic conditions and other factors and will adjust such estimates and assumptions when facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates.

Management believes there have been no significant changes during the three and nine month periods ended September 30, 2016 to the items that the Company disclosed as its critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

### Forward-Looking Statements

This Quarterly Report on 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 Quarterly Report on Form 10-Q are forward-looking. We use words such as "believe," "expect," "anticipate," "intends," "estimate," "forecast," "project," "will," "should" and similar expressions to identify forward-looking statements. Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from any future results, performance or achievements expressed or implied by such statements. Potential risks, among others, that could cause actual results to differ materially are discussed under "Part I – Item 1A. Risk Factors" of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015 and include, but are not limited to: our ability to successfully integrate acquired businesses and realize the synergies from acquisitions, including PMFG, as well as a number of factors related to our business, including economic and financial market conditions generally and economic conditions in CECO's service areas; dependence on fixed price contracts and the risks associated therewith, including actual costs exceeding estimates and method of accounting for contract revenue; fluctuations in operating results from period to period due to seasonality of the business; the effect of growth on CECO's infrastructure, resources, and existing sales; the ability to expand operations in both new and existing markets; the potential for contract delay or cancellation; changes in or developments with respect to any litigation or investigation; the potential for fluctuations in prices for manufactured components and raw materials; the substantial amount of debt incurred in connection with our recent acquisitions and our ability to repay or refinance it or incur additional debt in the future; the impact of federal, state or local government regulations; economic and political conditions generally; and the effect of competition in the environmental, energy and fluid handling and filtration industries. Many of these risks are beyond management's ability to control or predict. Should one or more of these risks or uncertainties materialize, or should the assumptions prove incorrect, actual results may vary in material aspects from those currently anticipated. Investors are 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. Furthermore, forward-looking statements speak only as of the date they are made. Except as required under the federal securities laws or the rules and regulations of the SEC, we undertake no obligation to update or review any forward-looking statements, whether as a result of new information, future events or otherwise.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to certain market risks, primarily changes in interest rates. Market risk is the potential loss arising from adverse changes in market rates and prices, such as foreign currency exchange and interest rates. For the Company, these exposures are primarily related to changes in interest rates. We do not currently hold any derivatives or other financial instruments purely for trading or speculative purposes. However, we do have an interest rate swap in place as of September 30, 2016 to hedge against a portion of our interest rate exposure related to debt indexed to LIBOR market rates. See Note 8 to the condensed consolidated financial statements for further information on this interest rate swap.

The carrying value of the Company's long-term debt and current maturities of long-term debt was \$133.4 million at September 30, 2016. Market risk was estimated as the potential decrease (increase) in future earnings and cash flows resulting from hypothetical 10% increase (decrease) in the Company's estimated weighted average borrowing rate at September 30, 2016. Most of the interest on the Company's debt is indexed to either the LIBOR or EURIBOR market rates. The estimated impact of a hypothetical 10% change in the

estimated weighted average borrowing rate, excluding the portion of debt which has an interest rate fixed by the interest rate swap described above, at September 30, 2016 is \$0.3 million on an annual basis.

The Company has wholly-owned subsidiaries located in the Netherlands, Canada, the People's Republic of China, Mexico, United Kingdom, Singapore, and Chile. In the past, we have not hedged our foreign currency exposure, and fluctuations in exchange rates have not materially affected our operating results. Future changes in exchange rates may positively or negatively impact our revenues, operating expenses and earnings.

#### ITEM 4. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act")) that are designed to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were not effective due to material weaknesses in our internal control over financial reporting that existed as of September 30, 2016, as discussed below.

As previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, we identified the following material weaknesses:

- (1) The Company did not maintain internal control over financial reporting that was appropriately designed, adequately documented and operating effectively to support the accurate and timely reporting of revenue recognition. Specifically, the Company did not design and maintain effective controls to ensure:
  - revenue recognition policies are in accordance with generally accepted accounting principles;
  - estimates of percent complete are accurate;
  - all projects are supported by executed contracts, including approved change orders;
  - billings are approved;
  - there is appropriate systems access and controls over schedules; and
  - appropriate review of contracts by accounting personnel.
- (2) The Company did not implement effective internal control over financial reporting, either divisional specific or corporate monitoring controls for Zhongli in China acquired in December 2014 and PMFG acquired in September 2015.
- (3) The Company did not maintain a sufficient complement of personnel with an appropriate level of knowledge of accounting, experience and training commensurate with its financial reporting requirements and increased size due to recent acquisitions.
- (4) The Company did not maintain internal control over financial reporting that were appropriately designed, adequately documented and operated within its decentralized structure to:

- determine the completeness and accuracy of reports and spreadsheets used in the execution of internal controls over financial reporting;
- determine the appropriateness of manual journal entries;
- maintain an effective information technology general control environment, including restricting access to certain key financial systems and records to appropriate users; and
- maintain appropriate segregation of duties in the purchasing process.

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With respect to our internal control over financial reporting, these material weaknesses have been and continue to be discussed among management and our Audit Committee. Management intends to review, revise and improve our internal control over financial reporting until the material weaknesses in internal control over financial reporting are eliminated.

Management's specific remediation to address these material weaknesses will and has included among other items:

- (1) Determining that revenue recognition policies are in accordance with generally accepted accounting principles, verifying that estimates of percent complete are accurate, ensuring that executed contracts, including approved change orders, are supported and independently reviewed, and that billings are approved, as well as ensuring that appropriate system access and controls over schedules are maintained.
- (2) Replaced the unit specific site controller and augmented the staffing under such site controller with additional staff support from within our Asia regional structure. The corporate financial reporting function tasked with monitoring oversight of this specific reporting unit has augmented its review procedures and conducted an on-site review of the subject reporting unit in conjunction with our third-party outsourced internal audit provider that has a global presence.
- (3) Hired additional corporate personnel during the second quarter with an appropriate level of expertise, including a functional leader of internal audit to co-source with a newly engaged third-party outsourced internal audit provider with a global presence as well as augmented the corporate staff in our existing financial reporting function by hiring an experienced accounting manager with experience in financial reporting and internal controls over financial reporting.
- (4) Hired additional divisional level personnel, including an Environmental segment controller. Management will implement controls to test the completeness and accuracy of reports and spreadsheets used in the execution of internal control over financial reporting, implement independent review of manual journal entries, restrict access to certain key financial systems and records to appropriate users, as well as implement appropriate segregation of duties within the purchasing cycle.

We believe the initiated remediation measures will strengthen our internal control over financial reporting and should eventually remediate the material weaknesses identified. However, because we are still assessing the design and operating effectiveness of these measures and need to put more controls in place, the identified material weaknesses have not been remediated as of September 30, 2016. We will continue to monitor the effectiveness of these remediation measures and will make any changes and take such other actions that we deem appropriate.

We assessed the material weaknesses' impact to the consolidated financial statements to ensure they were prepared in accordance with GAAP and present fairly the consolidated financial position, financial results of operations and cash flows as of and for the nine months ended September 30, 2016. Based on these additional procedures and assessment, we concluded that the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q present fairly, in all material aspects, our financial position, results of operations and cash flows for the periods presented.

#### Changes in Internal Control Over Financial Reporting

We have begun to implement additional internal controls in conjunction with our remediation plan as described above. Other than these additional internal controls, there were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the Company's last fiscal quarter that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting, except as described above.

#### Limitations on the Effectiveness of Controls

Control systems, no matter how well conceived and operated, are designed to provide a reasonable, but not an absolute, level of assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. The Company conducts periodic evaluations of its internal controls to enhance, where necessary, its procedures and controls.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Information with respect to legal proceedings can be found in Note 14 “Commitments and Contingencies – Legal Matters” to the Condensed Consolidated Financial Statements contained in Part I, Item 1 of this Quarterly Report on Form 10-Q.

ITEM 1A. RISK FACTORS

There have been no material changes in the Company’s risk factors that we disclosed in “Part I – Item 1A. Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2015.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.





ITEM 6. EXHIBITS

- 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)
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

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

CECO Environmental Corp.

By: /s/ Edward J. Prajzner  
Edward J. Prajzner  
Chief Financial Officer and Secretary

Date: November 8, 2016