CONTINENTAL MATERIALS CORP
Form 10-Q
November 13, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **September 30, 2006**

OR

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

For the transition period from to

Commission File number **1-3834**

CONTINENTAL MATERIALS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**36-2274391**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

200 South Wacker Drive, Suite 4000, Chicago, Illinois 60606
(Address of principal executive offices) (Zip Code)

(312) 541-7200
(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 or the Exchange Act).

Yes o No x

Number of common shares outstanding at November 8, 2006 1,605,461

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

CONTINENTAL MATERIALS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
SEPTEMBER 30, 2006 and DECEMBER 31, 2005
(Unaudited)
(000 s omitted except share data)

	SEPTEMBER 30, 2006	DECEMBER 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,614	$ 6,829
Receivables, net	23,526	17,678
Receivable for insured losses	1,708	1,718
Inventories:		
Finished goods	8,420	7,650
Work in process	1,834	1,907
Raw materials and supplies	8,777	7,898
Prepaid expenses	4,628	3,910
Total current assets	51,507	47,590
Property, plant and equipment, net	32,202	28,844
Goodwill	8,439	7,374
Non-compete agreements	1,023	728
Other assets	2,236	2,524
	$ 95,407	$ 87,060
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	$ 2,000	$ 2,000
Accounts payable and accrued expenses	19,109	15,748
Liability for unpaid claims covered by insurance	1,708	1,718
Income taxes	539	342
Total current liabilities	23,356	19,808
Long-term debt	13,500	10,000
Deferred income taxes	3,681	3,681
Other long-term liabilities	1,908	2,264
SHAREHOLDERS EQUITY		
Common shares, $0.25 par value; authorized 3,000,000 shares; issued 2,574,264 shares	643	643
Capital in excess of par value	1,830	1,830
Retained earnings	66,989	65,331
Accumulated other comprehensive gains net of tax of $1 and $3 (interest rate swap adjustments)	3	6
Treasury shares, 968,803, at cost	(16,503)	(16,503)
	52,962	51,307
	$ 95,407	$ 87,060

See accompanying notes

CONTINENTAL MATERIALS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS, RETAINED EARNINGS
AND COMPREHENSIVE INCOME (LOSS)
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006 AND OCTOBER 1, 2005
(Unaudited)
(000 s omitted except per-share amounts)

	SEPTEMBER 30, 2006	**OCTOBER 1, 2005**
Sales	$ 40,924	$ 36,415
Costs and expenses:		
Cost of sales (exclusive of depreciation, depletion and amortization)	33,731	29,325
Depreciation, depletion and amortization	1,212	1,201
Selling and administrative	5,113	4,337
Gain on disposition of property and equipment	47	
	40,009	34,863
Operating income	915	1,552
Interest expense	(250)	(225)
Other income, net	137	37
Income before income taxes	802	1,364
Provision for income taxes	273	326
Net income	529	1,038
Retained earnings, beginning of period	66,460	63,230
Retained earnings, end of period	$ 66,989	$ 64,268
Basic earnings per share	$ .33	$ .66
Average shares outstanding	1,605	1,563
Diluted earnings per share	$ .33	$ .65
Average shares outstanding	1,605	1,596
Comprehensive income:		
Net income	$ 529	$ 1,038
Comprehensive (loss) income from interest rate swap, net of tax of $(3) and $2	(5)	18
	$ 524	$ 1,056

See accompanying notes

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CONTINENTAL MATERIALS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS
AND COMPREHENSIVE INCOME (LOSS)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND OCTOBER 1, 2005
(Unaudited)
(000 s omitted except per-share amounts)

	SEPTEMBER 30, 2006	**OCTOBER 1, 2005**
Sales	$ 118,312	$ 104,445
Costs and expenses:		
Cost of sales (exclusive of depreciation, depletion and amortization)	96,669	84,668
Depreciation, depletion and amortization	3,651	3,632
Selling and administrative	15,314	13,744
Gain on disposition of property and equipment	193	115
	115,441	101,929
Operating income	2,871	2,516
Interest expense	(548)	(515)
Other income, net	189	107
Income before income taxes	2,512	2,108
Provision for income taxes	854	413
Net income	1,658	1,695
Retained earnings, beginning of period	65,331	62,573
Retained earnings, end of period	$ 66,989	$ 64,268
Basic earnings per share	$ 1.03	$ 1.06
Average shares outstanding	1,605	1,601
Diluted earnings per share	$ 1.03	$ 1.03
Average shares outstanding	1,605	1,643
Comprehensive income:		
Net income	$ 1,658	$ 1,695
Comprehensive (loss) income from interest rate swap, net of tax of $(2) and $41	(3)	65
	$ 1,655	$ 1,760

See accompanying notes

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CONTINENTAL MATERIALS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 AND OCTOBER 1, 2005
(Unaudited)
(000 s omitted)

	SEPTEMBER 30, 2006	OCTOBER 1, 2005
Net cash (used in) provided by operating activities	$ (274)	$ 2,869
Investing activities:		
Cash paid for acquisitions of assets of certain businesses	(2,452)	
Capital expenditures	(5,036)	(3,239)
Proceeds from sale of property and equipment	214	130
Net cash used in investing activities	(7,274)	(3,109)
Financing activities:		
Long-term borrowings	5,000	5,000
Repayment of long-term debt	(1,500)	(1,500)
Payment on note issued for acquisition	(167)	
Proceeds from exercise of stock options		488
Payment to acquire treasury stock		(4,079)
Net cash provided by (used in) financing activities	3,333	(91)
Net decrease in cash and cash equivalents	(4,215)	(331)
Cash and cash equivalents:		
Beginning of period	6,829	2,828
End of period	$ 2,614	$ 2,497
Supplemental disclosures of cash flow items:		
Cash paid during the nine months for:		
Interest	$ 734	$ 626
Income taxes	656	573
Supplemental disclosures of noncash investing and financing activities		
Note issued as partial consideration for ASCI purchase	$ 1,000	$
Value of shares tendered as payment related to exercise of stock options		93

See accompanying notes

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CONTINENTAL MATERIALS CORPORATION
SECURITIES AND EXCHANGE COMMISSION FORM 10-Q
NOTES TO THE QUARTERLY CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
QUARTER ENDED SEPTEMBER 30, 2006
(Unaudited)

1. The unaudited interim condensed consolidated financial statements included herein are prepared pursuant to the rules and regulations for reporting on Form 10-Q. Accordingly, certain information and footnote disclosures normally accompanying the annual consolidated financial statements have been omitted. The interim condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s latest annual report on Form 10-K. For reasons more fully discussed in Note 6, the segment information for the third quarter of 2005 has been restated. In the opinion of management, the condensed consolidated financial statements includes all adjustments (none of which were other than normal recurring adjustments) necessary for a fair statement of the results for the interim periods.

2. The provision for income taxes for the quarter ended September 30, 2006 of 34% is the same as the estimated effective rate of 34% for the year.

3. Operating results for the first nine months of 2006 are not necessarily indicative of performance for the entire year. Historically, sales of the Evaporative Cooling segment are higher in the first and second quarters, sales of the Concrete, Aggregates and Construction Supplies segment are higher in the second and third quarters and sales of the Heating and Cooling segment are higher in the third and fourth quarters. Sales of the Door segment have not shown strong seasonal fluctuations in recent years.

4. The following is a reconciliation of the calculation of basic and diluted earnings per share (EPS) for the three and nine months ended September 30, 2006 and October 1, 2005 (amounts in thousands except per-share data).

	Three months ended			**Nine months ended**		
	Income	**Shares**	**Per-share earnings**	**Income**	**Shares**	**Per-share earnings**
September 30, 2006						
Basic EPS	$ 529	1,605	$ .33	$ 1,658	1,605	$ 1.03
Effect of dilutive options						
Diluted EPS	$ 529	1,605	$ .33	$ 1,658	1,605	$ 1.03
October 1, 2005						
Basic EPS	$ 1,038	1,563	$ .66	$ 1,695	1,601	$ 1.06
Effect of dilutive options		33			42	
Diluted EPS	$ 1,038	1,596	$ .65	$ 1,695	1,643	$ 1.03

5. On June 8, 2006, the Company entered into the Fourth Amendment to Revolving Credit and Term Loan Agreement amending the Company s existing Credit Agreement. The Fourth Amendment increased the principal amount of the term loan portion of the Credit Agreement by $5,000,000 and increased the revolving credit facility by $5,000,000. With the increase in the term loan and revolving credit amounts, the total loan commitment, at the time of the signing, was $31,500,000. At the filing date of this Form 10-Q, the commitment had been reduced to $30,500,000 due to term loan repayments of $1,000,000, as scheduled.

The additional $5,000,000 proceeds of the term loan facility were drawn at the close of business, June 30, 2006 in conjunction with the acquisition discussed in Note 7. The amount available under the revolving credit facility of the Credit Agreement was increased primarily due to increased stand-by letters of credit requirements to insurance carriers in support of self-insured amounts under the Company s risk management program and to provide additional liquidity. All other material terms of the Credit Agreement remain in force, except to the extent they have been modified by the Fourth Amendment as described in this paragraph.

6. The Company operates primarily in two industry groups, HVAC and Construction Products. Prior to the 2005 fiscal year, the Company reported its financial results in two reportable segments, essentially along the lines of these two industry groups. The reporting segments were titled the Heating and Air Conditioning segment and

the Construction Materials segment. Prior to filing the annual report on Form 10-K for the 2005 fiscal year, management determined that its segment disclosures did not comply with Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information. As a result, the financial information presented for 2005 in the table below has been restated.

Prior to filing the annual report on Form 10-K for the 2005 fiscal year, management concluded that there are four reportable segments within its two principal industry groups; the Heating and Cooling segment and the Evaporative Cooling segment in the HVAC industry group and the Concrete, Aggregates and Construction Supplies segment and the Door segment in the Construction Products industry group. The Heating and Cooling segment produces and sells gas-fired wall furnaces, console heaters and fan coils from the Company s wholly-owned subsidiary, Williams Furnace Co. of Colton, California. The Evaporative Cooling segment produces and sells evaporative coolers from the Company s wholly-owned subsidiary, Phoenix Manufacturing, Inc. of Phoenix, Arizona. The operations of these two segments were previously combined and reported as the Heating and Air Conditioning segment. Sales of these two segments are nationwide, but are concentrated in the southwestern United States. Concrete, Aggregates and Construction Supplies are offered from numerous locations along the Front Range of Colorado operated by the Company s wholly-owned subsidiaries Castle Concrete Company and Transit Mix Concrete Co. (TMC), of Colorado Springs, Transit Mix of Pueblo, Inc. of Pueblo and Rocky Mountain Ready Mix Concrete, Inc. of Denver. Doors are fabricated and sold along with the related hardware from the Company s wholly-owned subsidiary, McKinney Door and Hardware, Inc. (MDHI) of Pueblo, Colorado. The operations of these two segments were previously combined and reported as the Construction Materials segment. Sales of these two segments are highly concentrated in the Front Range area in Colorado although door sales are also made throughout the United States.

The Company evaluates the performance of its segments and allocates resources to them based on a number of criteria including operating income, return on investment and other strategic objectives. Operating income is determined by deducting operating expenses from all revenues. In computing operating income, none of the following has been added or deducted: unallocated corporate expenses, interest, other income or loss or income taxes.

In addition to the above reporting segments, an Unallocated Corporate classification is used to report the unallocated expenses of the corporate office which provides treasury, insurance and tax services as well as strategic business planning and general management services and an Other classification is used to report a small real estate operation. Expenses related to the corporate information technology group are allocated to all locations, including the corporate office.

The following table presents information about reported segments for the nine month and three month periods ended September 30, 2006 and October 1, 2005 along with the items necessary to reconcile the segment information to the totals reported in the financial statements (amounts in thousands except in footnotes):

	Construction Products			**HVAC Products**					
	Concrete, Aggregates & Construction Supplies	**Doors**	**Combined Construction Products**	**Heating and Cooling**	**Evaporative Cooling**	**Combined HVAC Products**	**Unallocated Corporate**	**Other**	**Total**
2006									
Nine Months									
Revenues from external customers	$ 74,442	$ 6,816	$ 81,258	$ 18,628	$ 18,163	$ 36,791	$ 5	$ 258	$ 118,312
Depreciation, depletion and amortization	2,748	101	2,849	296	450	746	56		3,651
Operating income (loss)	5,179	504	5,683	(570)	250	(320)	(2,573)	81	2,871
Segment assets	57,547	3,412	60,959	19,660	10,048	29,708	4,677	63	95,407
Capital expenditures (a)	6,388	70	6,458	158	207	365	2		6,825
Three Months									
Revenues from external customers	$ 27,236	$ 2,399	$ 29,635	$ 6,997	$ 4,204	$ 11,201	$ 2	$ 86	$ 40,924
Depreciation, depletion and amortization	912	34	946	98	150	248	18		1,212
Operating income (loss)	2,069	209	2,278	(421)	(81)	(502)	(888)	27	915
Segment assets	57,547	3,412	60,959	19,660	10,048	29,708	4,677	63	95,407
Capital expenditures	1,321	5	1,326	56	45	101			1,427

(a) Capital expenditures for the Concrete, Aggregates and Construction Supplies segment include $1.735 million purchased on June 30, 2006 as part of the purchase of certain assets of ASCI, a concrete producer

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in Colorado Springs. Capital expenditures for the Door segment include $54 thousand purchased on January 1, 2006 as part of the purchase of the assets of Colorado State Safe & Lock Co. (CSSL). Also see Note 7.

	Construction Products				**HVAC Products**				
	Concrete, Aggregates & Construction Supplies	**Doors**	**Combined Construction Products (a)**	**Heating and Cooling**	**Evaporative Cooling**	**Combined HVAC Products (a)**	**Unallocated Corporate**	**Other**	**Total**
2005									
Nine Months as restated									
Revenues from external customers	$ 62,383	$ 6,428	$ 68,811	$ 18,428	$ 16,948	$ 35,376	$	$ 258	$ 104,445
Depreciation, depletion and amortization	2,709	68	2,777	357	432	789	66		3,632
Operating income (loss)	2,884	620	3,504	1,275	261	1,536	(2,594)	70	2,516
Segment assets (b)	47,180	2,914	50,094	16,986	12,544	29,530	7,373	63	87,060
Capital expenditures	2,354	29	2,383	170	365	535	321		3,239
Three Months as restated									
Revenues from external customers	$ 22,702	$ 2,756	$ 25,458	$ 6,955	$ 3,916	$ 10,871	$	$ 86	$ 36,415
Depreciation, depletion and amortization	902	24	926	108	144	252	23		1,201
Operating income (loss)	1,413	360	1,773	553	(49)	504	(752)	27	1,552
Segment assets (b)	47,180	2,914	50,094	16,986	12,544	29,530	7,373	63	87,060
Capital expenditures	1,114		1,114	83	67	150	29		1,293

(a) Columns for 2005 represent the segments as reported in the Form 10-Q for the period ended October 1, 2005.

(b) Segment assets are as of December 31, 2005.

There are no differences in the basis of segmentation or in the basis of measurement of segment profit or loss from the last annual report.

7. On January 1, 2006 the Company purchased the assets of CSSL, a company in Colorado Springs offering electronic access and locking capabilities, for $352,000. The assets were acquired by MDHI in the Door segment. The preliminary purchase price allocation included $100,000 of goodwill and $100,000 for a non-compete agreement. The non-compete agreement is being amortized over its four year term.

On June 30, 2006 the Company purchased certain assets of ASCI, a concrete producer in Colorado Springs for $2,100,000 of cash and a $1,000,000 Note. The assets were acquired by TMC in the Concrete, Aggregates and Construction Supplies segment. The preliminary purchase price allocation included $1,735,000 of plant and equipment, $965,000 of goodwill, $300,000 for a non-compete agreement and $100,000 for a restriction of use agreement. The non-compete and the restriction of use agreements are being amortized over their terms of five years and ten years, respectively.

Both purchases were accounted for as acquisitions of a business under SFAS No. 141, Standards of Accounting for Business Combinations. The goodwill related to the above two purchases represents the only changes to the Company s recorded goodwill during 2006.

The following unaudited pro forma summary financial information summarizes the estimated combined results of operations of the Company, ASCI and CSSL assuming that the acquisitions of ASCI and CSSL had taken place on January 2, 2005. The unaudited pro forma combined results of operations were prepared on the basis of information provided to the Company by the former management of ASCI and CSSL and no representation is made by the Company with respect to the accuracy of such information. The pro forma combined results of operations reflect adjustments for interest expense, additional depreciation based on the fair market value of plant and equipment, amortization of identifiable intangibles and income tax expense.

The pro forma financial information presented below for the year ended December 31, 2005 includes the full year results for ASCI and CSSL, as adjusted for the items noted above. The pro forma financial information for the nine months ended September 30, 2006 includes the results of ASCI from January 1, 2006 through April 30, 2006, as adjusted for the items noted above. ASCI s interim financial information for May and June of 2006 were not made available to the Company. Amounts are in thousands except per share amounts.

	Nine Months Ended September 30, 2006	Year Ended December 31, 2005
Net sales	$ 120,608	$ 149,022
Net income	1,685	3,079
Basic earnings per share	1.05	1.92
Diluted earnings per share	1.05	1.89

The unaudited pro forma combined results of operations are not necessarily indicative of, and do not purport to represent, what the Company s results of operations or financial condition actually would have been had the acquisitions been made as of January 2, 2005. Due to competitive conditions, the Company did not expect to, and has not, retained all of the concrete volume or market share previously attained by ASCI.

8. Identifiable intangible assets as of September 30, 2006 consisted of five amortizable non-compete agreements, including the non-compete agreements related to CSSL acquired during the first fiscal quarter of 2006 and the purchase of ASCI during the second fiscal quarter of 2006 (see Note 7). The non-compete agreements were carried at $1,023,000, net of $1,477,000 accumulated amortization. The pre-tax amortization expense for intangible assets during the quarter ended September 30, 2006 was $81,000. Based upon the intangible assets recorded on the balance sheet at September 30, 2006, amortization expense for the next five years is estimated to be as follows: 2006 $277,000, 2007 $233,000, 2008 $220,000, 2009 $220,000, and 2010 $195,000.

9. The interest rate swap agreement is reported consistent with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and its related amendment, SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities which require recognition of derivatives as either assets or liabilities and measurement at fair value. The change in accumulated other comprehensive income net of taxes from January 1, 2006 to September 30, 2006 was as follows (amounts in thousands):

Balance at January 1, 2006	$6
Comprehensive income, net of tax of $1	3
Balance at April 1, 2006	9
Comprehensive loss, net of tax of $0	(1)
Balance at July 1, 2006	8
Comprehensive loss, net of tax of $(3)	(5)
Balance at September 30, 2006	$3

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

The following Management s Discussion and Analysis gives effect to the restatement discussed in Note 6.

<u>Company Overview</u>

The Company operates in four reportable segments within its two principal industry groups; the Heating and Cooling segment and the Evaporative Cooling segment in the HVAC industry group and the Concrete, Aggregates and Construction Supplies segment and the Door segment in the Construction Products industry group.

The Heating and Cooling segment produces and sells gas-fired wall furnaces, console heaters and fan coils from the Company s wholly-owned subsidiary, Williams Furnace Co. of Colton, California. The Evaporative Cooling segment produces and sells evaporative coolers from the Company s wholly-owned subsidiary, Phoenix Manufacturing, Inc. of Phoenix, Arizona. Concrete, Aggregates and Construction Supplies are offered from numerous locations along the Front Range of Colorado operated by the Company s wholly-owned subsidiaries Castle Concrete Company and Transit Mix Concrete Co. (TMC), of Colorado Springs, Transit Mix of Pueblo, Inc. of Pueblo and Rocky Mountain Ready Mix Concrete, Inc. of Denver.

Doors are fabricated and sold along with the related hardware from the Company s wholly-owned subsidiary, McKinney Door and Hardware, Inc. (MDHI) of Pueblo, Colorado.

In addition to the above reporting segments, an Unallocated Corporate classification is used to report the unallocated expenses of the corporate office which provides treasury, insurance and tax services as well as strategic business planning and general management services and an Other classification is used to report a small real estate operation. Expenses related to the corporate information technology group are allocated to all locations, including the corporate office.

Financial Condition

Sales of the Company s HVAC products are seasonal and weather sensitive except for fan coils. Revenues in the Company s Concrete, Aggregates and Construction Supplies segment are influenced by the level of construction activity and weather conditions along the Front Range of Colorado. Sales for the Door segment are not as strongly seasonal nor are they much affected by weather conditions. Historically, the Company has experienced operating losses during the first quarter except when the weather is mild along the Front Range. Operating results typically improve in the second and third quarters reflecting more favorable weather conditions in Colorado and the seasonal sales of Evaporative Cooling segment. Fourth quarter results can vary based on weather conditions in Colorado as well as in the principal markets for the Company s heating equipment. The Company typically experiences operating cash flow deficits during the first half of the year reflecting operating results, the use of sales dating programs (extended payment terms) related to the Evaporative Cooling segment and payments of the prior year s accrued incentive bonuses and Company profit-sharing contributions. As a result, the Company s borrowings against its revolving credit facility tend to peak during the second quarter and then decline over the remainder of the year. This trend has continued thus far in 2006.

As expected, the Company s cash flow from operations during the quarter ended September 30, 2006 was positive ($1,909,000) allowing the payoff of the revolving credit facility balance. The seasonality of sales, production schedules and the sales dating programs related to the evaporative cooler product line have historically produced strong cash flow in the third quarter of each year. For the nine months ended September 30, 2006, operations used $274,000 of cash compared to the $2,869,000 of cash provided during the first nine months of 2005. The decline in cash flow was primarily due to a significant increase in receivables ($3,974,000 relative to year-end) resulting from the increase in sales of $4,509,000 during the third quarter of 2006 as compared to the 2005 quarter.

On January 1, 2006 the Company purchased the assets of CSSL, a company in Colorado Springs offering electronic access and locking capabilities, for $352,000 in cash. The assets were acquired by MDHI in the Door segment. The purchase price allocation included $100,000 of goodwill and $100,000 for a non-compete agreement. On June 30, 2006 the Company purchased certain assets of ASCI, a concrete producer in Colorado Springs, for $2,100,000 of cash and a $1,000,000 Note (remaining balance due on the Note at September 30, 2006 is $833,000). The assets were acquired by TMC in the Concrete, Aggregates and Construction Supplies segment. The preliminary purchase price allocation included $965,000 of goodwill, $300,000 for a non-compete agreement and $100,000 for a restriction of use agreement. The $5,036,000 of capital expenditures, primarily for the Concrete, Aggregates and Construction Supplies segment, consisted primarily of routine equipment replacements.

As more fully discussed in Note 5, the principal amount of the term loan was increased by $5 million. Approximately $2.1 million of the proceeds were used to fund the purchase of ASCI discussed above. The balance of the additional term loan proceeds will be used for business expansion. Scheduled debt repayments of $1,500,000 were made during the first nine months of 2006.

As expected, the Company paid off its revolving credit facility during the 2006 third quarter. During the first nine months of 2006, the highest amount of Company borrowings outstanding under the revolving credit agreement was $4,500,000 and the average amount outstanding was $900,000.

The Company believes that anticipated cash flow from operations, supplemented by seasonal borrowings against the revolving line of credit, (which was unused at September 30, 2006) will be sufficient to cover expected cash needs, including servicing debt and planned capital expenditures for at least the next twelve months.

Operations   Comparison of Quarter Ended September 30, 2006 to Quarter Ended October 1, 2005

Historically, the Company has experienced strong operating results during the third quarter as sales in the Concrete, Aggregates and Construction Supplies segment peak due to weather more conducive to construction activity. The 2006 operating results were consistent with this trend. Consolidated sales during the third quarter of 2006 were $40,924,000 compared to $36,415,000 in the third quarter of 2005.

All segments except Door reported increased sales for the quarter lead by a 20.0% increase from the Concrete, Aggregates and Construction Supplies segment. Cost of sales as a percentage of sales increased from 80.5% to 82.4% due to narrower margins principally in the Heating and Cooling and Evaporative Cooling segments. Increased copper, aluminum and steel costs were the predominant reasons for the decline in margins. Selling and administrative costs increased in all segments both in amount and as a percentage of sales except for the Concrete, Aggregates and Construction Supplies segment where the expenses as a percentage of sales declined. Sales and administrative costs were significantly higher in the Heating and Cooling segment. The reasons for the changes in these costs are discussed by segment, below. The resulting operating income of $915,000 trailed the $1,552,000 reported for the third quarter of 2005.

Interest expense increased from $225,000 for the third quarter of 2005 to $250,000 in the 2006 quarter due to increased average debt and higher interest rates.

A discussion of operations by segment follows.

Construction Products

The table below presents a summary of operating information for the two reportable segments within the Construction Products group for the quarters ended September 30, 2006 and October 1, 2005 (amounts in thousands):

	Concrete, Aggregates and Construction Supplies			**Doors**		
Quarter ended September 30, 2006						
Revenues from external customers	$	27,236		$	2,399	
Segment operating income	2,069			209		
Operating income as a percent of sales	7.6		%	8.7		%
Segment assets as of September 30, 2006	$	57,547		$	3,412	
Return on assets	3.6		%	6.1		%
Quarter ended October 1, 2005						
Revenues from external customers	$	22,702		$	2,756	
Segment operating income	1,413			360		
Operating income as a percent of sales	6.2		%	13.1		%
Segment assets as of October 1, 2005	$	49,101		$	4,018	
Return on assets	2.9		%	9.0		%

Concrete, Aggregates and Construction Supplies Segment

Sales in the Concrete, Aggregates and Construction Supplies segment for the third quarter of 2006 increased 20.0% over the prior year s comparable quarter as a result of increased volume and improved pricing. Concrete and aggregates volumes improved despite the beginning of a slowdown in construction activity along the Front Range of Colorado. The increase in our concrete volume was due to continuing work on three large jobs in the Pueblo area. Concrete pricing improved during the third quarter of 2006 although the increases were again largely instituted to offset increased cement and fuel costs. Cement supplies eased during the third quarter of 2006 as overall construction activity declined along the Front Range of Colorado. Construction supplies sales volume declined approximately 5.8% in the third quarter of 2006 compared to the third quarter of 2005. The decline reflects the slowdown in construction activity while also being affected by the timing of shipments.

Operating income improved in the 2006 quarter over the 2005 quarter as a result of the increase in volumes, pricing increases that slightly outpaced increased costs and delivery efficiencies on the three large concrete jobs noted above. Operating results for the aggregates operations during the 2006 quarter were depressed due

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to flooding of our two Arkansas River operations in July and a second flood at our Pueblo East pit in late August. Both were the result of heavy rains in the area. All expenses incurred to date to repair the damage and resume production have been expensed in operating expenses. Full recovery from the flood damage had not been completed as of the end of the quarter. Management is in the process of documenting the property and business losses to determine whether either of the claims will exceed our insurance policy deductibles. Selling and administrative costs increased during the third quarter of 2006 compared to the 2005 quarter due to sales increases; however these costs declined as a percentage of sales from 6.9% for the 2005 quarter to 6.2% for the 2006 quarter. The percentage decline was achieved through the continuing consolidation of administrative functions into the Colorado Springs office as well as the fixed nature of some expenses which did not increase proportionately to sales. As a result, both operating income as a percent of sales and return on assets improved in the 2006 quarter over the prior year s quarter.

Door Segment

Sales during the third quarter of 2006 in the Door segment declined $357,000 from the comparable 2005 quarter primarily due to the timing of shipments as order backlog remains strong. Sales during a specific quarter can be heavily influenced by customer requests to either accelerate or delay shipments of jobs to better coincide with their own construction schedule.

Operating income declined from $360,000 during the third quarter of 2005 to $209,000 for the 2006 quarter as a result of the lower sales and increased costs of sales. Steel prices as well as pricing decisions in response to competitive conditions contributed to the decline in margin. Selling and administrative costs during the third quarter of 2006 remained relatively constant in terms of dollars as compared to the 2005 quarter; however they increased as a percentage of sales when compared to the 2005 quarter due to the decline in sales in the 2006 quarter. As a result, both operating income as a percent of sales and return on assets declined in the 2006 quarter from the prior year s quarter.

HVAC Products

The table below presents a summary of operating information for the two reportable segments within the HVAC products group for the quarters ended September 30, 2006 and October 1, 2005 (amounts in thousands):

	Heating and Cooling		**Evaporative Cooling**	
Quarter ended September 30, 2006				
Revenues from external customers	$ 6,997		$ 4,204	
Segment operating income	(421	)	(81	)
Operating income as a percent of sales	(6.0	)%	(1.9	)%
Segment assets as of September 30, 2006	$ 19,660		$ 10,048	
Return on assets	(2.1	)%	(.8	)%
Quarter ended October 1, 2005				
Revenues from external customers	$ 6,955		$ 3,916	
Segment operating income (loss)	553		(49	)
Operating income as a percent of sales	8.0	%	(1.3	)%
Segment assets as of October 1, 2005	$ 17,808		$ 10,717	
Return on assets	3.1	%	(.5	)%

Heating and Cooling Segment

Sales in the Heating and Cooling segment remained relatively constant during the third quarter of 2006 at $6,997,000 as compared to the 2005 quarter. An increase in fan coil sales was largely offset by lower furnace volume. Management believes the lower furnace volume is probably due to the timing of sales while the increase in fan coil volume is attributable to the Company s restructuring of its sales representative network and the addition of internal sales and support staff. Cost of sales as a percentage of sales increased during the third quarter of 2006 as compared to the comparable quarter of 2005 due to pricing decisions made to retain a national home center account and increases in copper, aluminum and steel costs.

Operating income declined from $553,000 during the third quarter of 2005 to a loss of $421,000 for the 2006 quarter as a result of the narrower margins discussed above and increased selling and administrative expenses. Selling and administrative expenses were higher due to the addition of personnel in the sales and engineering

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departments and the opening of a sales and service center in Oklahoma City, Oklahoma. As a result, both operating income as a percent of sales and return on assets declined in the 2006 quarter compared to the prior year s quarter.

Evaporative Cooling Segment

Sales in the Evaporative Cooling segment increased $288,000, or 7.4%, during the third quarter of 2006 over the comparable 2005 quarter. A shift of product mix to larger industrial units prompted the improved sales despite the overall decline in cooler unit volume.

The operating loss increased slightly during the 2006 quarter due to an increase in cost of sales as a percentage of sales attributable to higher material and utility costs. Selling and administrative expenses, primarily compensation costs, were reduced partially offsetting the effect of the rising material and utility costs on operating results. As a result, both operating income as a percent of sales and return on assets declined in the 2006 quarter compared to the prior year s quarter.

Operations - Comparison of Nine Months Ended September 30, 2006 to Nine Months Ended October 1, 2005

Consolidated sales during the first nine months of 2006 were $118,312,000 compared to $104,445,000 during the first nine months of 2005. All segments reported increased sales for the nine months ended September 30, 2006 compared to the nine months ended October 1, 2005 lead by a 19.3% increase from the Concrete, Aggregates and Construction Supplies segment. Cost of sales as a percentage of sales increased during the nine months ended September 30, 2006 compared to the prior year s period. Similar to the quarter s results, the increase was due to higher copper, aluminum and steel costs in the Heating and Cooling, Evaporative Cooling and Door segments. Selling and administrative costs increased in dollars; however they declined as a percentage of sales. Operating results by segment are discussed below. Unallocated Corporate and Other operating results for 2006 remained unchanged from the prior year. The resulting operating income of $2,871,000 exceeded the $2,516,000 reported for the first nine months of 2005.

A discussion of operations by segment follows.

Construction Products

The table below presents a summary of operating information for the two reportable segments within the Construction Products group for the nine months ended September 30, 2006 and October 1, 2005 (amounts in thousands):

	Concrete, Aggregates and Construction Supplies			**Doors**		
Nine Months ended September 30, 2006						
Revenues from external customers	$	74,442		$	6,816	
Segment operating income	5,179			504		
Operating income as a percent of sales	7.0		%	7.4		%
Segment assets as of September 30, 2006	$	57,547		$	3,412	
Return on assets	9.0		%	14.8		%
Nine Months ended October 1, 2005						
Revenues from external customers	$	62,383		$	6,428	
Segment operating income	2,884			620		
Operating income as a percent of sales	4.6		%	9.6		%
Segment assets as of October 1, 2005	$	49,101		$	4,018	
Return on assets	5.9		%	15.4		%

Concrete, Aggregates and Construction Supplies Segment

Sales in the Concrete, Aggregates and Construction Supplies segment for the first nine months of 2006 increased 19.3% over the prior year s comparable period due to the reasons noted above and favorable weather during the first quarter of 2006.

Operating income improved to $5,179,000 during the 2006 period from $2,884,000 for the 2005 period due to the improved margins and reduction of selling and administrative costs as a percentage of sales as discussed above. The flooding, also discussed above, negatively impacted the overall results. As a result, both operating income as a percent of sales and return on assets improved for the nine months ended September 30, 2006 compared to the nine months ended October 1, 2005.

Door Segment

Sales in the Door segment for the first nine months of 2006 increased $388,000 over the comparable 2005 period primarily due to the electronic access product line acquired at the beginning of the 2006 year.

Operating income declined from $620,000 during the first nine months of 2005 to $504,000 for the 2006 period chiefly due to tighter margins resulting from higher steel prices and pricing decisions made in response to more competitive bidding on available jobs. Increases in both depreciation and selling and administrative costs also depressed operating income. As a result, operating income as a percent of sales declined in 2006 compared to the 2005 period. The return on assets was less affected by the decline in operating income as segment assets at September 30, 2006 were lower than the prior year s balance as a result of a reduced receivables balance attributed to the timing of collections.

HVAC Products

The table below presents a summary of operating information for the two reportable segments within the HVAC products group for the nine months ended September 30, 2006 and October 1, 2005 (amounts in thousands):

	Heating and Cooling	**Evaporative Cooling**
Nine Months ended September 30, 2006		
Revenues from external customers	$ 18,628	$ 18,163
Segment operating (loss) income	(570)	250
Operating income as a percent of sales	(3.1)%	1.4 %
Segment assets as of September 30, 2006	$ 19,660	$ 10,048
Return on assets	(2.9)%	2.5 %
Nine Months ended October 1, 2005		
Revenues from external customers	$ 18,428	$ 16,948
Segment operating income	1,275	261
Operating income as a percent of sales	6.9 %	1.5 %
Segment assets as of October 1, 2005	$ 17,808	$ 10,717
Return on assets	7.2 %	2.4 %

Heating and Cooling Segment

Sales in the Heating and Cooling segment increased $200,000, or 1.1%, during the first nine months of 2006 over the comparable 2005 period. While furnace volume was slightly lower during the first nine months of 2006, fan coil sales more than made up the difference. The reasons for the changes are the same as described in the discussion of the third quarter s results, above.

Operating income declined from $1,275,000 during the first nine months of 2005 to a loss of $570,000 for the 2006 period. The decrease was the result of lower margins due to the pricing decisions made to retain a national home center account, higher copper, aluminum and steel material costs not fully recaptured by higher selling prices, and increased selling and administrative expenses. Selling and administrative costs were higher due to the above noted addition of personnel and opening of a sales and service center in Oklahoma City, Oklahoma. As a result, both operating income as a percent of sales and the return on assets declined for the first nine months of 2006 from the prior year s period.

Evaporative Cooling Segment

Sales in the Evaporative Cooling segment increased $1,215,000, or 7.2%, during the first nine months of 2006 over the comparable 2005 period. Hot, dry weather in the markets served prompted the improved sales. The change in product mix to larger industrial units during the third quarter also contributed to the improved sales.

The operating profit declined modestly from $261,000 during the first nine months of 2005 to $250,000 for the first nine months of 2006. Cost of sales as a percentage of sales increased in 2006 due to the higher

Materials costs and continued competitive pressures on selling prices discussed above. Selling and administrative expenses during 2006 were held to the prior year s level. As a result, operating income as a percent of sales declined slightly. The return on assets improved for the 2006 period largely due to a decrease in segment assets resulting from lower inventory levels and net property, plant and equipment at September 30, 2006.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States which require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of September 30, 2006 and December 31, 2005 and affect the reported amounts of revenues and expenses for the periods reported. Actual results could differ from those estimates.

Information with respect to the Company s critical accounting policies which the Company believes could have the most significant effect on the Company s reported results and require subjective or complex judgments by management is contained in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

OUTLOOK

Concrete prices throughout our Colorado markets have improved compared to 2005 although a substantial portion of the price increase was in response to higher prices paid for cement and fuel. The slow-down in new home construction along the Front Range in Colorado will likely affect future volume and may result in more competitive pricing and lower profit margins. Commercial and industrial construction seems to be steady. The sales volume and backlog for the door segment remains strong.

Sales of the Heating and Cooling segment and the Evaporative Cooling segment are not expected to grow significantly and will remain weather sensitive. However, the demand for fan coil products in the heating and cooling segment is expected to continue to improve as a result of the restructured sales representative network and the addition of sales and support staff. Improved margins are dependent on a number of factors including competitive conditions and commodity costs.

RECENTLY ISSUED ACCOUNTING STANDARDS

The Company discusses recently issued accounting standards and tax law changes in the Critical Accounting Policies section under Item 7 and in Note 1 to Consolidated Financial Statements in Item 8 of the Company s Annual Report on Form 10-K for the fiscal year 2005. Other than as discussed in those sections, or as noted below, the Company does not currently have any transactions or circumstances that have been addressed by recently issued accounting pronouncements. Adoption of any of these statements or pronouncements are not expected to have a material impact on the Company s results of operations, financial position or liquidity.

In November 2004, SFAS No. 151, Inventory Costs - An Amendment of ARB No. 43, Chapter 4, was issued which amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight and rehandling costs be recognized as current -period charges regardless of whether they meet the criteria of so abnormal as stated in ARB No. 43. Additionally, SFAS 151 requires the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 1, 2005. The Company adopted this standard in the first quarter of fiscal 2006 and such adoption did not have a material impact on its consolidated results of operations, cash flows or financial condition.

In March 2005, the Emerging Issues Task Force reached a consensus on Issue 04-6, Accounting for Stripping Costs in the Mining Industry (EITF 04-6) which became effective on January 1, 2006. EITF 04-6 states that stripping costs incurred after the first saleable minerals are extracted from the mine (i.e. post-production stripping costs) should be considered costs of the extracted minerals and recognized as a component of inventory to be recognized in costs of sales in the same period as the revenue from the sale of the inventory. As disclosed in the Company s 2005 Annual Report on Form 10-K, the Company has historically treated post-

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production stripping costs in the manner prescribed by EITF 04-6 and, therefore, adoption of EITF 04-6 in the first quarter of fiscal 2006 did not have a material impact on the Company s consolidated results of operations, cash flows or financial condition.

In June 2006 FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes was issued which clarifies the application of SFAS No. 109, Accounting for Income Taxes by establishing a threshold condition that a tax position must meet for any part of the benefit of that position to be recognized in financial statements. In addition to recognition, Interpretation No. 48 provides guidance on measurement, derecognition, classification and disclosure of tax positions. Interpretation No. 48 is effective for fiscal years beginning after December 15, 2006, with earlier adoption permitted as of the beginning of a fiscal year for which annual or interim financial statements have not yet been issued. The Company has not had sufficient time to evaluate what impact Interpretation No. 48 might have on the Company s consolidated results of operations or financial condition.

The Company has determined that it qualifies for certain deductions that the American Jobs Creation Act of 2004 provides for income from qualified domestic production activities. Although the effect of the deduction is not expected to have a material effect on the tax provision for 2006, a preliminary estimate of the deduction was included in the determination of the tax provision.

FORWARD-LOOKING STATEMENTS

The foregoing discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended. Such forward-looking statements are based on the beliefs of the Company s management as well as on assumptions made by and information available to the Company at the time such statements were made. When used in this Report, words such as anticipates, believes, contemplates, estimates, expects, plans, projects, and similar expressions are intended to identify forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of factors including but not limited to: weather, interest rates, availability of raw materials and their related costs, the Company s ability to timely resume operations after the flooding at its two Arkansas River aggregates sites, national and local economic conditions and competitive forces. Some of these factors are discussed in more detail in the Company s 2005 Annual Report on Form 10-K. Changes in accounting pronouncements could also alter projected results. Forward-looking statements speak only as of the date they were made, and the Company undertakes no obligation to publicly update them.

Item 3. Quantitative And Qualitative Disclosures About Market Risk

There have been no material changes in the market risks that the Company is exposed to since those discussed in the Company s 2005 Annual Report on Form 10-K. At September 30, 2006, the amount subject to the interest rate swap agreement was $1,500,000. Also see Note 9 to the quarterly financial statements above.

Item 4. Controls and Procedures

(a) Disclosure Controls and Procedures.

The Company s Chief Executive Officer and Chief Financial Officer, with the participation of management, have evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of September 30, 2006. Based on that evaluation, they have concluded that the Company s disclosure controls and procedures as of such date are effective and are reasonably designed to ensure that all material information relating to the Company (including its subsidiaries) required to be disclosed in this quarterly report is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

(b) Changes in Internal Control Over Financial Reporting.

There have been no significant changes in the Company s internal control over financial reporting identified in connection with the evaluation of such internal control that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II - OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

There were no purchases made by the Company of its common stock to become treasury stock for the period July 1 through September 30, 2006.

On January 19, 1999, the Company initiated purchases under the current open-ended program to repurchase its common stock. Purchases are made on the open market or in block trades at the discretion of management. The dollar amount authorized for the program has been periodically increased by the Board of Directors and approved by the Company s two banks as required by the Company s Revolving Credit and Term Loan Agreement. The June 28, 2005 amendment to the Loan Agreement provides that the Company may make purchases of its own stock in an amount not to exceed $1,438,000, separate from purchases made in connection with the 2005 tender offer and the exercise of cash-less stock options. At September 30, 2006, the maximum dollar value of shares that may yet be purchased under the program was $1,418,942. Since the 2005 tender offer, management has not actively sought to repurchase shares.

Item 4. Submission of Matters to a Vote of Security Holders

(a) The 2006 Annual Meeting of the Stockholders of the Company was held on September 13, 2006.

(b) At that meeting, three individuals, all of whom are current directors, were elected to serve until the 2009 Annual Meeting by the following votes:

Director	Shares For	Shares Against	Shares Withheld
Thomas H. Carmody	1,457,907		103,844
Ronald J. Gidwitz	1,446,076		115,675
Darrell M. Trent	1,457,947		103,804

There were no broker non-votes.

The following directors terms of office continued after the 2006 Meeting until the Annual Meetings of the respective years as set forth opposite their names below:

Directors	Expiration of Term
William D. Andrews	2007
Betsy R. Gidwitz	2007
James G. Gidwitz	2007
Ralph W. Gidwitz	2008
Peter E. Thieriot	2008
Theodore R. Tetzlaff	2008

(c) In addition to the above election, the appointment of the independent registered public accounting firm of Deloitte & Touche LLP was ratified by the following vote:

For	Against	Abstain
1,559,487	2,264	

There were no broker non-votes.

(d) Not applicable.

Item 6. Exhibits

Exhibits

Exhibit No.	**Description**
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) and Rule 13a-14(d)/15d-14(d) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) and Rule 13a-14(d)/15d-14(d) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002

SIGNATURE

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

CONTINENTAL MATERIALS CORPORATION

Date: November 13, 2006	By:	/S/ Joseph J. Sum Joseph J. Sum, Vice President and Chief Financial Officer