

GENCOR INDUSTRIES INC
Form 10-Q
February 11, 2008
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE
ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2007**

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 number 001-11703

GENCOR INDUSTRIES, INC.

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Delaware **59-0933147**
(State or other jurisdiction of (I.R.S. Employer
incorporated or organization) Identification No.)
5201 North Orange Blossom Trail, Orlando, Florida 32810
(Address of principal executive offices) (Zip Code)
(407) 290-6000
(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 and 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 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 Accelerated Filer Non-accelerated Filer

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

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

| Class | Outstanding at January 30, 2008 |
|--------------------------------|---------------------------------|
| Common stock, \$.10 par value | 7,967,372 shares |
| Class B stock, \$.10 par value | 1,642,998 shares |

Table of Contents**GENCOR INDUSTRIES, INC.**

Index

| | Page |
|--|-------------|
| <u>Part I. Financial Information</u> | |
| Item 1. Financial Statements | |
| <u>Condensed consolidated balance sheets</u> December 31, 2007 (Unaudited) and September 30, 2007 | 3 |
| <u>Unaudited condensed consolidated statements of income</u> Three-months ended December 31, 2007 and 2006 | 4 |
| <u>Unaudited condensed consolidated statements of cash flows</u> Three-months ended December 31, 2007 and 2006 | 5 |
| <u>Notes to condensed consolidated financial statements</u> | 6 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 8 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 11 |
| Item 4. <u>Controls and Procedures</u> | 12 |
| <u>Part II. Other Information</u> | |
| Item 6. <u>Exhibits</u> | 13 |

Signatures

14

This Report and our other communications and statements may contain forward-looking statements, within the meaning of Section 27A of the Securities Act for 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended including statements about our beliefs, plans, objectives, goals, expectations, estimates, projections and intentions. These statements are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond our control. The words may, could, should, would, believe, anticipate, estimate, expect, intend, plan, target, goal, and similar expressions are intended to identify forward-looking statements, by their nature, are subject to risks and uncertainties. Our actual future results may differ materially from those set forth in our forward-looking statements. For information concerning these factors and related matters which may impact these forward-looking statements, see Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, in this Report, and the following sections of our Annual Report on Form 10-K for the year ended September 30, 2007: (a) Risk Factors in Part I, Item 1A and (b) Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7. However, other factors besides those referenced could adversely affect our results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by us herein speak as of the date of this Report. We do not undertake to update any forward-looking statement, except as required by law.

Table of Contents**Part I. Financial Information****GENCOR INDUSTRIES, INC.****Condensed Consolidated Balance Sheets***(In thousands, except per share data)*

| | December 31, 2007 (Unaudited) | September 30, 2007 |
|--|-------------------------------------|-----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 6,646 | \$ 3,707 |
| Marketable securities at market value (Cost \$57,000 at December 31, 2007 and \$42,000 at September 30, 2007) | 67,273 | 51,780 |
| Accounts receivable, less allowance for doubtful accounts of \$1,813 (\$1,685 at September 30, 2007) | 5,014 | 4,570 |
| Other receivables | 236 | 288 |
| Inventories, net | 39,307 | 34,694 |
| Prepaid expenses | 1,618 | 1,353 |
| Total current assets | 120,094 | 96,392 |
| Property and equipment, net | 7,898 | 7,660 |
| Other assets | 173 | 175 |
| Total assets | \$ 128,165 | \$ 104,227 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 5,181 | \$ 4,132 |
| Customer deposits | 6,400 | 1,414 |
| Income and other taxes payable | 10,375 | 2,164 |
| Accrued expense | 4,376 | 6,338 |
| Total current liabilities | 26,332 | 14,048 |
| Long-term debt | | |
| Deferred income taxes | 4,949 | 6,398 |
| Total liabilities | 31,281 | 20,446 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, par value \$.10 per share; authorized 300,000 shares; none issued | | |
| Common stock, par value \$.10 per share; 15,000,000 shares authorized; 7,967,372 shares issued at December 31, 2007 and September 30, 2007 | 797 | 797 |
| Class B stock, par value \$.10 per share; 6,000,000 shares authorized 1,642,998 shares issued at December 31, 2007 and September 30, 2007 | 164 | 164 |
| Unearned compensation | (101) | (135) |
| Capital in excess of par value | 10,520 | 10,520 |
| Retained earnings | 85,246 | 72,136 |
| Accumulated other comprehensive income | 258 | 299 |
| Total stockholders' equity | 96,884 | 83,781 |
| | \$ 128,165 | \$ 104,227 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**GENCOR INDUSTRIES, INC.****Unaudited Condensed Consolidated Statements of Operations***(In thousands, except per share data)*

| | Three Months Ended December 31, | |
|--|--|-------------|
| | 2007 | 2006 |
| Net revenue | \$ 18,323 | \$ 12,370 |
| Cost and expense: | | |
| Production costs | 13,949 | 9,337 |
| Product engineering and development | 604 | 591 |
| Selling, general and administrative | 2,498 | 2,668 |
| | 17,051 | 12,596 |
| Operating income (loss) | 1,272 | (226) |
| Other income (expense): | | |
| Interest income | 49 | 24 |
| Interest expense | (1) | (21) |
| Income from investees | 15,625 | 3,285 |
| Loss on sale of assets | | (1,633) |
| Increase in value of marketable securities | 493 | 2,139 |
| Miscellaneous | 3,427 | 32 |
| | 19,593 | 3,826 |
| Income before income taxes | 20,865 | 3,600 |
| Income taxes | 7,755 | 2,117 |
| Net income | \$ 13,110 | \$ 1,483 |
| Basic and diluted earnings per common share: | | |
| Basic earnings per share | \$ 1.36 | \$ 0.15 |
| Diluted earnings per share | \$ 1.36 | \$ 0.15 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**GENCOR INDUSTRIES, INC.****Unaudited Condensed Consolidated Statements of Cash Flows***In Thousands*

| | Three Months Ended December 31, | |
|---|--|-------------|
| | 2007 | 2006 |
| Cash flows from operations: | | |
| Net income | \$ 13,110 | \$ 1,483 |
| Adjustments to reconcile net income to cash provided (used) by operations: | | |
| Increase in Marketable securities | (15,000) | (3,000) |
| Increase in market value of Marketable securities | (493) | (2,139) |
| Depreciation and amortization | 222 | 217 |
| Income from investees | (15,625) | (3,285) |
| Loss on sale of assets | | 1,633 |
| Change in assets and liabilities: | | |
| Inventories | (4,613) | (6,340) |
| Customer deposits | 4,986 | 2,384 |
| Income and other taxes payable | 6,885 | 2,173 |
| Other | (1,659) | (530) |
| Total adjustments | (25,297) | (8,887) |
| Cash provided (used) by operations | (12,187) | (7,404) |
| Cash flows from (used for) investing activities: | | |
| Distribution from unconsolidated investees | 15,625 | 3,285 |
| Proceeds from sale of assets | | 5,481 |
| Capital expenditures | (458) | (225) |
| Cash from (used for) investing activities | 15,167 | 8,541 |
| Cash flows used for financing activities: | | |
| Repayment of debt | | |
| Net Borrowings | | |
| Cash provided (used) for financing activities | | |
| Effect of exchange rate changes on cash | (41) | (3) |
| Net increase in cash | 2,939 | 1,134 |
| Cash and cash equivalents at: | | |
| Beginning of quarter | 3,707 | 1,110 |
| End of quarter | \$ 6,646 | \$ 2,244 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**GENCOR INDUSTRIES, INC.****Notes to Condensed Consolidated Financial Statements***All amounts in thousands, except per share amounts***Note 1 Basis of Presentation**

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all material adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three months ended December 31, 2007 are not necessarily indicative of the results that may be expected for the year ended September 30, 2008.

The balance sheet at September 30, 2007 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Gencor Industries, Inc. Annual Report on Form 10-K for the year ended September 30, 2007.

Note 2 Marketable Securities

Marketable securities are categorized as trading securities and stated at market value. Market value is determined using the quoted closing or latest bid prices. Realized gains and losses on investment transactions are determined by specific identification and are recognized as incurred in the statement of income. Net unrealized gains and losses are reported in the statement of operations and represent the change in the market value of investment holdings during the period. At December 31, 2007, marketable securities consisted of \$48,863 in municipal bonds and \$18,410 in equity stocks.

Note 3 Inventories

The components of inventory consist of the following:

| | December 31, 2007 | September 30, 2007 |
|-----------------|------------------------------|-------------------------------|
| Raw materials | \$ 16,053 | \$ 19,905 |
| Work in process | 14,892 | 6,669 |
| Finished goods | 6,403 | 6,165 |
| Used equipment | 1,959 | 1,955 |
| | \$ 39,307 | \$ 34,694 |

Table of Contents**Note 4 Earnings Per Share Data**

The following table sets forth the computation of basic and diluted earnings per share for the periods indicated.

| | 2007 | 2006 |
|---|-----------|----------|
| Net income | \$ 13,110 | \$ 1,483 |
| Denominator (shares in thousands): | | |
| Weighted average shares outstanding | 9,610 | 9,945 |
| Effect of dilutive stock options | 1 | 4 |
| Denominator for diluted EPS computation | 9,611 | 9,949 |
| Per common share: | | |
| Net income | \$ 1.36 | \$ 0.15 |
| Diluted: | | |
| Net income | \$ 1.36 | \$ 0.15 |

Note 5 Comprehensive Income

The total comprehensive income for the three-months ended December 31, 2007 and 2006 was \$13,069 and \$1,480, respectively. Total comprehensive income differs from net income due to gains and losses resulting from foreign currency translation, which are reflected separately in the shareholders' equity section of the balance sheet under the caption Accumulated other comprehensive income. Gains and losses resulting from foreign currency transactions are included in income.

During the quarter ended December 31, 2006, the Company sold land and buildings for \$5,481 resulting in a loss of \$1,633 after an adjustment of \$1,905 for the cumulative translation adjustment related to the assets sold.

Note 6 Income From Investees

The Company owns a 45% interest in Carbontronics LLC and a 25% interest in Carbontronics Fuels LLC and Carbontronics II, LLC. These interests were earned as part of value of risk on contracts to build four synthetic fuel production plants during 1998. The Company has no basis in these equity investments or requirement to provide future funding. The operations of Carbontronics LLC consist of the receipt of contingent payments from the sales of the plants and the distribution thereof to its members. Carbontronics LLC has no other significant operations or assets. The operations of Carbontronics II, LLC consist of the receipt of royalty payments from the plants and the distribution thereof to its members. Carbontronics II, LLC has no other significant operations or assets. Any income arising from these investments is dependent upon tax credits (adjusted for operating losses at the fuel plants) being generated as a result of synthetic fuel production, which will be recorded as received. The Company received \$15,625 in distributions in the quarter ended December 31, 2007, and \$3,285 in the quarter ended December 31, 2006. These distributions are subject to state and Federal income taxes.

The existing synthetic fuel tax credit legislation expired at the end of calendar year 2007. Consequently, the four synthetic fuel plants are being decommissioned. The plants are in process of being sold or transferred to site owners in exchange for a release of all contracted liabilities related to the removal of plants from the sites. The administrative partner has informed the Company that there will be no operations in calendar 2008 and the partnership affairs will be finalized in early 2008. It is not possible to predict the amount, if any, of final distributions from the partnerships upon the final disposition and winding-up of operations.

Table of Contents

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

All amounts in thousands, except per share amounts

Results of Operations

Net sales for the quarters ended December 31, 2007 and 2006 were \$18,323 and \$12,370, respectively. Domestic sales during the first quarter of fiscal 2008 were \$17,775 reflecting an increase of \$5,816 from the first quarter of fiscal 2007. Domestic sales were higher than the prior year's quarter primarily due to the general improvement in the road-building industry. Foreign sales increased \$137 compared to the first quarter of fiscal 2007. Our revenues are concentrated in the asphalt-related business and subject to a seasonal slow-down during the third and fourth quarters of the calendar year.

Gross margins as a percent of net sales remained consistent at 24-25% for both years.

Selling and administrative expense decreased \$170 due mainly to lower legal costs for the quarter ended December 31, 2007.

We own a 45% interest in Carbontronics LLC and a 25% interest in Carbontronics Fuels LLC and Carbontronics II, LLC. These interests were earned as part of value of risk on contracts to build four synthetic fuel production plants during 1998. We have no basis in these equity investments or requirement to provide future funding. The operations of Carbontronics LLC consist of the receipt of contingent payments from the sales of the plants and the distribution thereof to its members. Carbontronics LLC has no other significant operations or assets. The operations of Carbontronics II, LLC consist of the receipt of royalty payments from the plants and the distribution thereof to its members. Carbontronics II, LLC has no other significant operations or assets. Any income arising from these investments is dependent upon tax credits (adjusted for operating losses at the fuel plants) being generated as a result of synthetic fuel production, which will be recorded as received. We received \$15,625 in distributions in the quarter ended December 31, 2007, and \$3,285 in the quarter ended December 31, 2006. These distributions are subject to state and Federal income taxes.

The existing synthetic fuel tax credit legislation expired at the end of calendar year 2007. Consequently, the four synthetic fuel plants are being decommissioned. The plants are in process of being sold or transferred to site owners in exchange for a release of all contracted liabilities related to the removal of plants from the sites. The administrative partner has informed the Company that there will be no operations in calendar 2008 and the partnership affairs will be finalized in early 2008. It is not possible to predict the amount, if any, of final distributions from the partnerships upon the final disposition and winding-up of operations.

For the three months ended December 31, 2007, the increase in value of our marketable securities is a result of additional net cash invested of \$15,000 and an increase of \$493 in the market value of the securities held in the portfolio. For the three months ended December 31, 2006, the increase in value of our marketable securities is a result of additional net cash invested of \$3,000 and increase of \$2,139 increase in the market value of the securities held in the portfolio. Included in other income for the three months ended December 31, 2007 was the receipt of \$4,100 in resolution of an outstanding claim against a former service provider less related legal costs of \$700. The terms of the settlement are confidential and we do not expect any further collections or expenses related to this matter. During the quarter ended December 31, 2006, we sold land and buildings for \$5,481 resulting in a loss of \$1,633 after an adjustment of \$1,905 for the cumulative translation adjustment related to the assets sold.

Income tax expense increased by \$5,638 compared to the first quarter of fiscal 2007, reflecting the increase in pre-tax income.

Table of Contents

Liquidity and Capital Resources

We entered into a Revolving Credit and Security Agreement with PNC Bank, N.A. The Agreement established a three year revolving \$20 million credit facility and was renewed through July 31, 2009. The facility provides for advances based on accounts receivable, inventory and real estate. The facility includes a \$2 million limit on letters of credit. At December 31, 2007, we had \$.7 million of letters of credit outstanding. The interest rate at December 31, 2007, is at LIBOR plus 2.00% and subject to change based upon the Fixed Charge Coverage Ratio. We are required to maintain a Fixed Charge Coverage Ratio of 1.1:1. There are no required repayments as long as there are no defaults and there is adequate eligible collateral. Substantially all of our assets are pledged as security under the Agreement. We had no long term debt outstanding at December 31, 2007 or 2006.

As of December 31, 2007, we had \$6.6 million in cash and cash equivalents, and \$67.3 million in marketable securities. The marketable securities are invested in stocks and bonds through a professional investment advisor. The securities may be liquidated at any time into cash and cash equivalents.

Inventory and customer deposits increased due to increases in our orders as our backlog is at \$24.5 million (\$28.5 million the prior year) and having completed several orders in advance of scheduled shipment dates. Income taxes payable increased due to the increase in taxable income and the movement from deferred taxes related to the timing of taxes due on income from investees.

Seasonality

We are concentrated in the asphalt-related business and subject to a seasonal slow-down during the third and fourth quarters of the calendar year. Traditionally, our customers do not purchase new equipment for shipment during the summer and fall months to avoid disrupting their peak season for highway construction and repair work. This slow-down often results in lower reported sales and earnings and/or losses during the first and fourth quarters of our fiscal year ended September 30.

Forward-Looking Information

This Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), which represent our expectations and beliefs, including, but not limited to, statements concerning gross margins, sales of our products and future financing plans. These statements by their nature involve substantial risks and uncertainties, certain of which are beyond our control. Actual results may differ materially depending on a variety of important factors, including the financial condition of our customers, changes in the economic and competitive environments and demand for our products.

For information concerning these factors and related matters, see the following sections of our Annual Report on Form 10-K for the year ended September 30, 2007: (a) Risk Factors in Part I, Item 1A and (b) Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7. However, other factors besides those referenced could adversely affect our results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by us herein speak as of the date of this Report. We do not undertake to update any forward-looking statement, except as required by law.

Critical Accounting Policies, Estimates and Assumptions

We believe the following discussion addresses our most critical accounting policies, which are those that are most important to the portrayal of our financial condition and results of operations and require management's most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Accounting policies, in addition to the critical accounting policies referenced below, are presented in Note 1 to our consolidated financial statement included in our Annual Report on form 10-K for the year ended September 30, 2007, Accounting Policies.

Table of Contents

Estimates and Assumptions

In preparing the consolidated financial statements, we use certain estimates and assumptions that may affect reported amounts and disclosures. Estimates and assumptions are used, among other places, when accounting for certain revenue (e.g. contract accounting), expense, and asset and liability valuations. We believe that the estimates and assumptions made in preparing the consolidated financial statements are reasonable, but are inherently uncertain and unpredictable. Assumptions may be incomplete or inaccurate and unanticipated events may occur. We are subject to risks and uncertainties that may cause actual results to differ from estimated results.

Revenues

Revenues from contracts for the design and manufacture of certain custom equipment are recognized under the percentage-of-completion method. Revenues from all other sales are recorded as the products are shipped or service is performed.

The percentage-of-completion method of accounting for long term contracts recognizes revenue in proportion to actual labor costs incurred as compared with total estimated labor costs expected to be incurred during the entire contract. All selling, general and administrative expenses are charged to operations as incurred. Provision is made for any anticipated contract losses in the period that the loss becomes evident.

Investment in Unconsolidated Investees

As of September 30, 2007, 2006, and 2005, we own a 45% interest in Carbontronics LLC and a 25% interest in Carbontronics Fuels LLC and Carbontronics II LLC. These interests were obtained as part of contracts to build four synthetic fuel production plants during 1998. We have no basis in these equity investments or requirement to provide future funding. Any income arising from these investments is dependent upon tax credits (adjusted for operating losses at the fuel plants) being generated as a result of synthetic fuel production, which will be recorded as received.

Off-Balance Sheet Arrangements

None

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company operates manufacturing facilities and sales offices principally located in the United States and the United Kingdom. The Company is subject to business risks inherent in non-U.S. activities, including political and economic uncertainty, import and export limitations, and market risk related to changes in interest rates and foreign currency exchange rates. The Company's principal currency exposure against the U.S. dollar is the British pound. Periodically, the Company will use derivative financial instruments consisting primarily of interest rate hedge agreements to manage exposures to interest rate changes. The Company's objective in managing our exposure to changes in interest rates on its variable rate debt is to limit their impact on earnings and cash flow and reduce its overall borrowing costs.

At December 31, 2007 and 2006, the Company had no debt outstanding. Under the Revolving Credit and Security Agreement, substantially all of the Company's borrowings will bear interest at variable rates based upon the prime rate or LIBOR.

The Company's marketable securities are invested in stocks and bonds through a professional investment advisor. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of securities, it is possible that changes in these risk factors could have an adverse material impact on the Company's results of operations or equity.

The Company's sensitivity analysis for interest rate risk excludes accounts receivable, accounts payable and accrued liabilities because of the short-term maturity of such instruments. The analysis does not consider the effect on other variables such as changes in sales volumes or management's actions with respect to levels of capital expenditures, future acquisitions or planned divestitures, all of which could be significantly influenced by changes in interest rates.

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company's principal executive officer and principal financial officer have conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-14(c) promulgated under the Exchange Act as of the end of the period covered by this Report. Based on their evaluation, the Company's principal executive officer and principal accounting officer concluded that the Company's disclosure controls and procedures are effective in ensuring that material information required to be disclosed is included in the reports that it files with the Securities and Exchange Commission.

Changes in Internal Control over Financial Reporting

There were no significant changes in the Company's internal controls or, to the knowledge of the management of the Company, in other factors that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting during the period covered by the report.

The Company is a non-accelerated filer and is not required to comply with requirements of Section 404 of the Sarbanes-Oxley Act of 2002 until its annual report for the fiscal year ending September 30, 2008.

Table of Contents

Part II. Other Information

Item 6. Exhibits

(a) Exhibits

- 31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
- 31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended
- 32.1 Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U. S. C. Section 1350.

Table of Contents

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.

GENCOR INDUSTRIES, INC.

February 11, 2008

By: /s/ E.J. Elliott
E.J. Elliott, Chairman and Chief Executive Officer

February 11, 2008

By: /s/ Scott W. Runkel
Scott W. Runkel, Chief Financial Officer
(Principal Financial and Accounting Officer)