CLEAN DIESEL TECHNOLOGIES INC
Form 10-Q
August 11, 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 June 30, 2006

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: 0-27432

CLEAN DIESEL TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	06-1393453
(State of Incorporation)	(I.R.S. Employer Identification No.)

Clean Diesel Technologies, Inc. 300 Atlantic Street - Suite 702 Stamford, CT	06901-3522
(Address of principal executive offices)	(Zip Code)

(203) 327-7050
(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 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 ___

Indicate by check mark whether the registrant is a large accelerated filer, 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 X

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

Yes ___ No X

As of August 11, 2006, there were outstanding 26,162,459 shares of Common Stock, par value $0.05 per share, of the registrant.

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CLEAN DIESEL TECHNOLOGIES, INC.

Form 10-Q for the Quarter Ended June 30, 2006

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Financial Statements

CLEAN DIESEL TECHNOLOGIES, INC.

CONDENSED BALANCE SHEETS

	(in thousands, except share data) JUNE 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,501	$ 4,513
Accounts receivable, net of allowance of $18 and $11 in 2006 and 2005, respectively	172	125
Inventories	452	285
Other current assets	128	94
Subscription receivable, net	0	488
TOTAL CURRENT ASSETS	3,253	5,505
Patents, net	593	567
Fixed assets, net of accumulated depreciation of $307 and $259 in 2006 and 2005, respectively	118	175
Other assets	37	27
TOTAL ASSETS	$ 4,001	$ 6,274
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Deferred revenue	0	9
Accounts payable and accrued expenses	775	487
TOTAL CURRENT LIABILITIES	775	496
STOCKHOLDERS' EQUITY:		
Preferred Stock, par value $0.05 per share, 100,000 shares authorized, no shares issued and outstanding	--	--
Common Stock, par value $0.05 per share, authorized 30,000,000 shares, issued and outstanding 26,162,459 and 25,369,358 shares respectively	1,308	1,268
Common Stock, par value $0.05 per share, subscribed and to be issued; 705,113 shares in 2005	0	35
Additional paid-in capital	44,285	44,068
Accumulated deficit	(42,367)	(39,593)
TOTAL STOCKHOLDERS' EQUITY	3,226	5,778
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 4,001	$ 6,274

See notes to condensed financial statements.

CLEAN DIESEL TECHNOLOGIES, INC.

CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)

	(in thousands except per share data)			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
REVENUE:				
Additive revenue	$ 145	$ 91	$ 296	$ 186
Hardware revenue	73	166	117	258
License, royalty and other revenue	61	11	135	16
Total revenue	279	268	548	460
COSTS AND EXPENSES:				
Cost of revenue	156	161	272	271
General and administrative	1,186	1,210	2,715	2,375
Research and development	177	88	395	147
Patent amortization and other patent expense	50	25	93	64
Loss from operations	(1,290)	(1,216)	(2,927)	(2,397)
Other income (expense):				
Foreign currency exchange gain/(loss)	79	(75)	93	(94)
Interest income	21	5	48	14
Miscellaneous income	0	0	12	0
Net loss	$ (1,190)	$ (1,286)	$ (2,774)	$ (2,477)
BASIC AND DILUTED LOSS PER COMMON SHARE	$ (0.05)	$ (0.07)	$ (0.11)	$ (0.14)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - BASIC AND DILUTED	26,111	17,171	26,098	17,168

See notes to condensed financial statements.

CLEAN DIESEL TECHNOLOGIES, INC.

CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	(in thousands)	
	Six Months Ended June 30,	
	2006	2005

OPERATING ACTIVITIES		
Net loss	$ (2,774)	$ (2,477)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	79	6
Write-off patent and bad debt provision	18	83
Non-cash compensation expense for stock options	106	--
Changes in operating assets and liabilities:		
Accounts receivable	(57)	(116)
Inventories	(161)	49
Other current assets and security deposits	(44)	(42)
Accounts payable and accrued expenses	381	(38)
Net cash used in operating activities	(2,452)	(2,535)
INVESTING ACTIVITIES		
Patent costs	(62)	(145)
Purchase of fixed assets	--	(60)
Net cash used in investing activities	(62)	(205)
FINANCING ACTIVITIES		
Proceeds from exercise of stock options	14	--
Proceeds from receipt of subscription receivable	488	--
Net cash provided by financing activities	502	--
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,012)	(2,740)
Cash and cash equivalents at beginning of period	4,513	4,265
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 2,501	$ 1,525
Non-cash financing activities		
Accrued expenses settled in common stock	$ 94	$ 71

See notes to condensed financial statements.

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CLEAN DIESEL TECHNOLOGIES, INC.

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006
(Unaudited)

NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited, 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 Rule 10-01 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 adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature. Operating results for the three-and six month periods ended June 30, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date but does not include all the information and notes required by generally accepted accounting principles for complete financial statement presentation. For further information, refer to the Financial Statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Clean Diesel Technologies, Inc. (the "Company" or "CDT") was incorporated in the State of Delaware on January 19, 1994, as a wholly owned subsidiary of Fuel-Tech N.V. ("Fuel Tech"). Effective December 12, 1995, Fuel Tech completed a Rights Offering of the Company's Common Stock that reduced its ownership in the Company to 27.6%. Fuel Tech currently holds a 7.0% interest in the Company as of June 30, 2006.

The Company is a specialty chemical and energy technology company supplying fuel additives and proprietary systems that reduce harmful emissions from internal combustion engines while improving fuel economy. The Company's Platinum Plus FBC fuel additive is registered with the EPA for on-highway use and is approved under the VERT-VSET procedure. The Platinum Plus FBC in combination with a diesel oxidation catalyst or a catalyzed wire mesh filter have both been verified by the EPA for retrofit emission reduction. The success of the Company's technologies will depend upon the market acceptance of the technologies and governmental regulations including corresponding foreign and state agencies.

Clean Diesel has been unable to generate positive cash flows from its operations in the past. The Company does not have any credit facilities available with financial institutions or other third parties. If the Company is unable to generate cash flow from operations in the future, Clean Diesel will be dependent upon external sources of best-efforts financing, of which there are no firm commitments or arrangements. Based on the current operating plan, management believes that the cash balance as of June 30, 2006 of $2.5 million will be sufficient to meet the cash needs into the first quarter of 2007. In the future, unless operating revenues are sufficient to meet operating expenses, the Company may need to access capital markets to fund operations by incurring indebtedness or issuing equity securities. The Company can provide no assurance that it will be successful in any future financing effort to obtain the necessary working capital to support operations or if such financing is available, it will be on acceptable terms. If management is unable to obtain the necessary financing from external sources, the Company may need to manage any cash shortfalls by taking measures which may include deferring or reducing the scope of commercialization efforts, reducing costs and overhead expenses, or otherwise curtailing operations, or obtaining funds by a disposition of assets or through arrangements with others that may require Clean Diesel to relinquish rights to certain of its technologies, or to license the rights to such technologies on terms that are less favorable to Clean Diesel than might otherwise be available. The condensed financial statements have been prepared on a going concern basis and do not reflect any adjustments that might result from the outcome of this uncertainty.

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

FOREIGN CURRENCY

The US dollar is considered the functional currency for CDT. CDT maintains a UK bank account for its UK representative office. Foreign currency translation gains or losses are recognized in the period incurred, which is included in other income (expense) in the accompanying statements of operations. CDT recorded a foreign currency gain of $79,000 and $93,000 on its UK bank holdings for the three and six months ended June 30, 2006 versus a loss of ($75,000) and ($94,000) for the same three and six month period ended June 30, 2005.

INVENTORIES

Inventories are stated at the lower of cost or market and consist of the following:

(in thousands)	JUNE 30, 2006	December 31, 2005
Finished Platinum Plus FBC	$ 146	$ 59
Platinum concentrate/metal	138	119
Hardware (ARIS and Purifier)	102	55
Other	66	52
Total inventory	$ 452	$ 285

REVENUE RECOGNITION

Clean Diesel Technologies generates revenue from the sale of additives including the Platinum Plus FBC products and concentrate; hardware including the EPA verified Purifier System and catalyzed wire mesh filter, ARIS injectors and dosing systems; and license, royalty fees and other revenue from the ARIS 2000 System and market analysis/consulting. CDT sells to end-user fleets, municipalities and construction companies, as well as fuel resellers, additive distribution companies and emission reduction companies.

CDT shipping terms are FOB shipping point but revenue is recognized when its products are received and collections are reasonably assured unless the purchase order or contract specifically requires CDT to provide installation of hardware. For hardware projects where CDT is responsible for installation either directly or indirectly (third-party contractor), revenue is recognized when the hardware is installed and/or accepted if the project requires inspection/acceptance.

License revenue is recognized when the license agreement is entered into, the license period commences, the technology rights, information and know-how have been transferred to the licensee and CDT does not have any ongoing responsibilities or performance requirements and collection is reasonably assured. Royalty income is recognized when earned.

In January 2006 Clean Diesel signed a one year contract with a new customer to provide certain consulting and market analysis services for a fee of 130,000 GBP (approximately $230,000). The Company is recognizing the revenue ratably over the 12 month term of the contract. During the three and six months ended June 30, 2006, the Company recorded $59,000 and $117,000, respectively, of revenues relating to this contract.

GEOGRAPHIC INFORMATION

CDT sells its Platinum Plus additives and licenses its ARIS systems throughout the world. A geographic breakdown of revenue consists of the following:

(in thousands)	Second Quarter 2006	Second Quarter 2005	Year to Date 2006	Year to Date 2005
REVENUE:				
US	$ 153	$ 247	$ 326	$ 427
UK/Europe	126	8	211	20
Asia	0	13	11	13
Total Revenue	$ 279	$ 268	$ 548	$ 460

Patents held by Clean Diesel consist of capitalized patent costs net of accumulated amortization and are as follows:

(in thousands)	JUNE 30, 2006	December 31, 2005
US patents, net	$ 157	$ 138
Foreign patents, net	436	429
Total patents, net	$ 593	$ 567

PATENT EXPENSE

CDT capitalizes all direct incremental costs associated with initial patent filing costs and amortizes the cost over the estimated remaining life of such patent. Patents are reviewed regularly and the remaining carrying value of any patents deemed not commercial or cost effective are written off. The expiration dates of CDT's patents, in numerous countries throughout the world, range from 2006 to 2025.

RESEARCH AND DEVELOPMENT COSTS

Costs relating to the research, development and testing of products are charged to operations as they are incurred. These costs include test programs, salary and benefits, consultancy fees, materials and certain testing equipment.

GENERAL AND ADMINISTRATIVE EXPENSE

General and administrative expense is summarized as the following:

(in thousands)	Second Quarter 2006	Second Quarter 2005	Year to Date 2006	Year to Date 2005
Compensation and benefits	$ 770	$ 791	$ 1,896	$ 1,554
Occupancy	104	129	210	241
Professional	231	216	432	398
Other	81	74	177	182
Total general and administrative expense	$ 1,186	$ 1,210	$ 2,715	$ 2,375

Included in the 2006 year to date compensation and benefit expense is $357,475 of severance charges related to the departure of James Valentine, President and Chief Operating Officer. Clean Diesel announced in January 2006 that Mr. Valentine had been "released from employment and resigned as director of the company." The balance sheet at June 30, 2006 includes accrued severance charges of $195,000 representing salary and benefit costs for the remainder of the one year employment contract between Clean Diesel and Mr. Valentine which is to be paid on a monthly basis through January 2007.

STOCK-BASED COMPENSATION

Effective January 1, 2006, Clean Diesel adopted Statement of Financial Accounting Standards No. 123 (Revised 2004), Share Based Payment (SFAS No. 123R), which requires a public entity to measure the cost of employee, officer and director services received in exchanged for an award of equity instruments based on the grant-date fair value of the award. SFAS No. 123R supersedes the Company's previous accounting under SFAS No. 123, accounting for Stock-Based Compensation (SFAS No. 123), which permitted the Company to account for such compensation under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25). Pursuant to APB No. 25, and related interpretations, no compensation cost had been recognized in connection with the issuance of stock options, as all options granted under the Company's stock option plan had an exercise price equal to or greater than the market value of the underlying common stock on the date of the grant.

The Company adopted SFAS No. 123R using the modified prospective transition method, which requires that compensation cost be recorded as earned for all unvested stock options outstanding at the beginning of the first fiscal year of adoption of SFAS No. 123R based upon the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and for compensation cost for all share-based payments granted or modified subsequent to the adoption, based on fair value estimated in accordance with the provisions of SFAS No. 123R. The Company's Financial Statements as of and for the three and six months ended June 30, 2006 reflect the impact of SFAS No. 123R. In accordance with the modified prospective transition method, the Company's Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123R. In the three and six months ended June 30, 2006, Clean Diesel recorded share-based compensation for options attributable to employees and officers of $53,000 and $106,000, or $0.00 and $0.00 per share which is included in the Company's net loss for the respective periods.

Clean Diesel has a 1994 stock option plan approved by shareholders for officers, directors, key employees of the Company, and consultants to the Company. Participants are eligible to receive incentive and/or nonqualified stock options. The stock option plan allows for total options granted to be up to 17.5% of outstanding common shares. The stock option plan is administered by the Compensation Committee of the Board of Directors. The selection of

participants, grant of options, determination of price and other conditions relating to the exercise of options are determined by the Compensation Committee of the Board of Directors and administered in accordance with the 1994 stock option plan.

Both incentive stock options and non-qualified options granted to employees, officers and directors under this plan are exercisable for a period of up to 10 years from the date of grant at an exercise price which is not less than the fair market value of the common stock on the date of the grant. The options typically grant one-third on grant date and one-third on the first and second grant anniversary dates except for Non-Executive Directors for which options fully vest upon granting.

A summary of the Company's stock option plans activity as of June 30, 2006, and changes during the six months then ended is as follows:

	Shares	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value
Outstanding, January 1, 2006	3,245,936	$ 2.06		
Granted	--	N/A		
Exercised	15,000	0.90		
Forfeited	47,167	2.00		
Expired	5,000	5.63		
Outstanding and expected to vest, June 30, 2006	3,178,769	$ 2.06	7.4	$ 382,000
Exercisable, June 30, 2006	2,809,437	$ 2.18	6.4	$ 253,000

The Company estimates the fair value of stock options using a Black-Scholes valuation model, consistent with the provisions of SFAS No. 123R, Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 107 and the Company's prior period pro forma disclosures of net earnings, including the fair value of stock-based compensation. Key input assumptions used to estimate the fair value of stock options include the expected term until exercise of the option, expected volatility of the Company's stock, the risk free interest rate, option forfeiture rates, and dividends, if any. The expected term of the options is based on a historical weighted average of exercised options. The expected volatility is derived from the historical volatility of the Company's stock on the UK London Stock Exchange AIM listing and the US Over the Counter listings for a period that matches the expected life of the option. The risk-free interest rate is the yield from a treasury bond or note corresponding to the expected term of the option. Option forfeiture rates are based on the Company's historical forfeiture rates. The Company has not paid dividends and does not expect to pay dividends in the future.

Compensation costs for stock options with graded vesting are recognized over the vesting period. As of June 30, 2006, there was $200,000 unrecognized compensation costs related to granted stock options. These costs are expected to be recognized over a weighted average period of 1.2 years.

No options have been granted in 2006. The weighted-average grant-date fair value of options granted for the three and six months ended June 30, 2005 was $1.18 and $1.12, respectively. The total intrinsic value of stock options exercised for the three and six months ended June 30, 2006 was $0 and $3,000, respectively. For the three and six month period of 2005, the total intrinsic value of stock options exercised was $0 and $0, respectively. In March 2005, the Company accelerated vesting of 363,000 options with fair market value of $498,000 in response to the issuance by FASB of SFAS No. 123R.

The fair value of each option grant in 2005 was estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted average assumptions:

	Second Quarter	Year To Date
Expected volatility	106.5%	104.3%
Weighted average expected volatility	106.5%	104.3%
Expected dividends	N/A	N/A
Expected term (in years)	4.3	4.3
Risk-free interest rates	4.1%	4.2%

SFAS No. 123 required disclosure of net income, on a pro forma basis, as if expense treatment had been applied. Had the Company elected to recognize compensation expense for the stock option plan, consistent with the method prescribed by SFAS No. 123R, the Company's net loss for the previous periods presented would have changed to the pro forma amounts as follows:

	Three Months Ended June 30, 2005	Yea Jun
	(Amounts in thousa except per share d	
Net loss	$ (1,286)	$
Deduct: Total stock based employee compensation expense Under fair value method for all awards, determined Net of related tax effects	(80)	
Pro forma net loss	$ (1,366)	$
Basic and diluted net loss per common share - as reported	$ (0.07)	$
Basic and diluted net loss per common share - pro forma	$ (0.08)	$

BASIC AND DILUTED LOSS PER COMMON SHARE

Basic and diluted loss per share is calculated in accordance with SFAS No. 128, "Earnings Per Share." Basic loss per share is computed by dividing net loss by the weighted-average shares outstanding during the reporting period. Diluted loss per share is computed similar to basic earnings per share, except that the weighted-average shares outstanding are increased to include additional shares from the assumed exercise of stock options and warrants, if dilutive, using the treasury stock method. CDT's computation of diluted net loss per share does not include common share equivalents associated with 3,179,000 and 2,763,000 options, respectively, and 507,000 and 507,000 warrants, respectively for the 2006 and 2005 periods, as the result would be anti-dilutive.

STOCKHOLDERS' EQUITY

Pursuant to a Regulation S exemption with respect to an offshore placement, Clean Diesel Technologies sold, effective November 11, 2005, 8.174 million shares of its common stock. The price of the common stock was 40 pence (GBP) per share (approximately $0.704 per share). The proceeds of the common stock issuance, was $5.5 million (net of $232,000 in expenses).

In addition, Clean Diesel Technologies received subscriptions for an additional $487,500 (net of $12,500 in expenses) related to the November 11th issuance of common stock for 0.7 million shares of common stock. The $487,500 was received in the first quarter 2006.

NOTE 3: RELATED PARTY TRANSACTIONS

The Company has a Management and Services Agreement with Fuel Tech. The agreement requires CDT to reimburse Fuel Tech for management, services and administrative expenses incurred on our behalf. The Company has agreed to pay Fuel Tech a fee equal to an additional 3% of the costs paid on behalf of administration (approximately $500 for the quarter and $1,000 year to date). Currently, and for the last three years CDT has reimbursed Fuel Tech for the expenses associated with one Fuel Tech officer/director who also serves as an officer/director of CDT. The Company believes the charges under the Management and Services Agreement are reasonable and fair. The Management and Services Agreement may be cancelled by either party by notifying the other in writing of the cancellation on or before May 15 in any year.

NOTE 4: COMMITMENTS

Clean Diesel Technologies leases 3,925 square feet of administrative office space at 300 Atlantic Street, Stamford, Connecticut. The five year lease through March 2009 has an annual cost of approximately $125,000, including rent, utilities and parking.

CDT leases 400 square feet of administrative space at 23 Bourne House, 475 Godstone Road in Surrey, England. The two and half year lease through September 2007 has an annual cost of approximately $33,000 including utilities and communication services.

CDT has signed a four year lease (through July 2008) for 2,750 square feet of warehouse space in Milford, Connecticut. Annual rent including utilities will be approximately $21,000.

Effective October 28, 1994, Fuel Tech granted two licenses to the Company for all patents and rights associated with its platinum fuel catalyst technology. Effective November 24, 1997, the licenses were canceled and Fuel Tech assigned to the Company all such patents and rights on terms substantially similar to the licenses. In exchange for the assignment, the Company pays Fuel Tech a royalty of 2.5% of its annual gross revenue from sales of the platinum fuel catalysts commencing in 1998. The royalty obligation expires in 2008. The Company may terminate the royalty obligation to Fuel Tech by payment of $3.3 million in 2006, and declining annually to $2.2 million in 2007 and $1.1 million in 2008. The Company as assignee and owner is responsible for maintaining the technology at its own expense. Royalty expense was $3,631 and $2,259 for the three months ended June 30, 2006 and 2005, respectively, and $7,387 and $4,663 for the six month period ended June 30, 2006 and 2005, respectively. The royalty expense payable to Fuel Tech at June 30, 2006 and 2005 is $7,387 and $4,663, respectively.

NOTE 5: CONCENTRATION

For the quarters ended June 30, 2006 and 2005 and year to date 2006 and 2005, Clean Diesel's largest customers as a percentage of sales were as follows:

REVENUE:	Second Quarter 2006	Second Quarter 2005	Year To Date 2006	Year To Date 2005
Customer A	16%	*	15%	10%
Customer B	18%	*	*	*
Customer C	21%	*	21%	*
Customer D	*	*	*	10%
Customer E	*	55%	*	32%

* Represents less than 10% revenue for that customer in the applicable period. There were no other customers that represented 10% or more of revenue for the shown periods.

In addition to the revenue concentration, at June 30, 2006 Clean Diesel has two customers that represent 39% of its gross accounts receivable balance. One of the customers is the same as listed in the revenue concentration chart above.

NOTE 6: ISSUANCE OF STOCK TO DIRECTOR FOR DIRECTOR'S FEES

On June 15, 2006 Clean Diesel issued 62,194 shares of common stock for payment of $94,250 of accrued 2005 non-executive directors' fees due to three non-executive directors. The shares are determined based on the average of the high and low price of the stock each quarter.

NOTE 7: NEW ACCOUNTING PRONOUNCEMENT

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No 109" (FIN 48), which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We do not expect the adoption of FIN 48 to have a material impact on our financial reporting and we are currently evaluating the impact, if any, the adoption of FIN 48 will have on our disclosure requirements.

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

FORWARD-LOOKING STATEMENTS

Statements in this Form 10-Q that are not historical facts, so-called "forward-looking statements," are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Investors are cautioned that all forward-looking statements involve risks and uncertainties, including those detailed in the Company's filings with the Securities and Exchange Commission. See "Risk Factors of the Business" in Item 1, "Business," and also

Item 7, "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, 2005.

RECENT DEVELOPMENTS

Clean Diesel's markets include alternative energy and emission reduction. With rising oil prices and diminishing supplies as well as pending global emission reduction requirements, the demand for Clean Diesel's technologies continues to increase. Recently, Clean Diesel has gained substantial interest and acceptance with original equipment manufacturers and Tier one suppliers. Many of the leading manufacturers or suppliers are now testing or negotiating with Clean Diesel for access to its technologies. Clean Diesel has also added several international distributors for its Platinum Plus FBC and made arrangements for a UK based toll blending operation to be utilized for production of the Platinum Plus FBC into the UK and continental Europe.

RESULTS OF OPERATIONS

2006 VERSUS 2005

Revenues and cost of revenue in the second quarter of 2006 were $279,000 and $156,000, respectively, versus $268,000 and $161,000, respectively for the 2005 second quarter. For the six months to date, 2006 revenue and cost of revenue were $548,000 and $272,000, respectively versus $460,000 and $271,000, respectively for the same six month period in 2005. Revenues consist of the following:

	Second Quarter		Year To Date	
(in thousands)	2006	2005	2006	2005
REVENUE:				
Additive	$ 145	$ 91	$ 296	$ 186
Hardware	73	166	117	258
License, royalty and other	61	11	135	16
Total revenue	$ 279	$ 268	$ 548	$ 460

In the foregoing table "Additive" includes the Platinum Plus FBC products and concentrate; "Hardware" includes the EPA verified Purifier System, ARIS injectors and dosing systems.

Additive revenue has increased as a result of the addition of new customers and expanding sales in several niche markets including mining and off road vehicles. The decrease in hardware sales is primarily the result of the timing of ARIS injector sales and the 2005 State of Pennsylvania grant project.

License, royalty and other revenue increased as a result of the income recognized for a consulting and market analysis project performed by Clean Diesel for a new International customer.

Clean Diesel's strategy is to license the ARIS 2000 NOx reduction system to other companies for an up-front fee for the technology and information transfer and a separate on-going royalty per unit payment. CDT currently has an exclusive license agreement for both stationary and mobile ARIS applications with DENOX, Inc. (transferred from Mitsui Ltd) for Japan. CDT has a non-exclusive license for both stationary and mobile ARIS applications in the United States with Combustion Components Associates of Monroe, Connecticut. CDT previously had an ARIS stationary license agreement for North America with the RJM Corporation of Norwalk, Connecticut, but as of August 2004 RJM was out of business and the ARIS license reverted back to CDT. CDT believes that the ARIS 2000 system can most effectively be commercialized through licensing several companies with a related business in these markets. Clean Diesel Technologies is actively seeking additional ARIS licensees for both mobile and stationary applications in the US, Europe and Asia.

General and administrative expenses decreased in the second quarter 2006 to $1,186,000 from $1,210,000 in 2005 and year to date 2006 increased to $2,715,000 from $2,375,000 in 2005 as summarized in the following table:

	Second Quarter 2006	Second Quarter 2005	Year To Date 2006	Year To Date 2005
(in thousands)				
Compensation and benefits	$ 770	$ 791	$ 1,896	$ 1,554
Occupancy	104	129	210	241
Professional	231	216	432	398
Other	81	74	177	182
Total general and administrative expenses	$ 1,186	$ 1,210	$ 2,715	$ 2,375

Included in the 2006 year to date compensation and benefit expense is $357,475 of severance charges related to the departure of James Valentine, President and Chief Operating Officer. Clean Diesel announced in January 2006 that Mr. Valentine had been "released from employment and resigned as director of the company." The balance sheet at June 30, 2006 includes accrued severance charges of $195,000 representing salary and benefit costs for the remainder of the one year employment contract between Clean Diesel and Mr. Valentine which is to be paid on a monthly basis through January 2007.

Compensation and benefit expense decreased slightly in the second quarter 2006 as the savings from the departure of the President and Chief Operating Officer was mostly offset by the salary and benefit expense of the new Chief Technology Officer. Professional fees increased as a result of Clean Diesel's listing on the German stock market.

For the first six months year to date compensation and benefit expense increased as a result of recognition of severance expense, the addition of a chief technology officer in July 2005 and the recognition of $106,000 in non-cash compensation expense relating to stock options granted prior to January 1, 2006 as required under Financial Accounting Standards 123R.

Research and development expense increased in the second quarter 2006 to $177,000 from $88,000 in 2005. For the six months year to date, research and development expenses increased to $395,000 in 2006 from $147,000 in 2005. The increase in research and development in 2006 is due to additional laboratory testing on the CWMF technology acquired from Mitsui and a new bio-fuel additive formulation.

Patent amortization and other costs increased to $50,000 in the second quarter

2006 versus $25,000 in 2005. For the six months to date in 2006 patent amortization and other costs increased to $93,000 from $64,000 in 2005. The 2006 increase is related to higher amortization related to prior period capitalization and patent legal fees related to recently granted European patents.

Interest income increased to $21,000 in the second quarter 2006 from $5,000 in 2005 and for the six months year to date to $48,000 from $14,000 in 2005 due to higher rates of return and the higher amount of invested funds in the first quarter and first six months of 2006 related to the November 2005 fundraising.

Inventory increased to $452,000 at June 30, 2006 from $285,000 at December 31, 2005 as Clean Diesel increased finished Platinum Plus FBC for its European operations. Clean Diesel also increased the inventory of onboard dosing systems to support Platinum Plus FBC sales in both the US and Europe.

Capitalized patents excluding accumulated depreciation increased to $718,000 at June 30, 2006 from $665,000 at December 31, 2005. As a technology company Clean Diesel is continuously filing patents. Clean Diesel also had

several key European patents grant recently and added several pending patents related to the wire mesh filter technology which was acquired from Mitsui in 2005.

LIQUIDITY AND SOURCES OF CAPITAL

Prior to 2000, the Company was primarily engaged in research and development and has incurred losses since inception aggregating $37,565,000 (excluding the effect of the non-cash preferred stock dividends on preferred shares prior to conversion to common). Clean Diesel is likely to incur losses through at least the next twelve months as it further pursues its commercialization efforts. Although the Company started selling limited quantities of Platinum Plus additive and the verified Purifier system and generating some ARIS licensing fees and royalties, operating revenue to date has been insufficient to cover operating expenses and the Company continues to be dependent upon proceeds from fundraising to finance its working capital requirements.

For the six months ended June 30, 2006 and 2005, the Company used cash of $2,452,000 and $2,535,000, respectively, in operating activities.

At June 30, 2006 and December 31, 2005, the Company had cash and cash equivalents of $2,501,000 and $4,513,000, respectively. The decrease in cash and cash equivalents in 2006 was the result of limited revenues and on-going operating costs. The Company anticipates incurring additional losses through at least 2006 as it further pursues its commercialization efforts.

Pursuant to a Regulation S exemption with respect to an offshore placement, Clean Diesel Technologies sold, effective November 11, 2005, 8.174 million shares of its common stock. The price of the common stock was 40 pence (GBP) per share (approximately $0.704 per share). The proceeds of the common stock issuance, was $5.5 million (net of $232,000 in expenses).

In addition, Clean Diesel Technologies received subscriptions for an additional $487,500 (net of $12,500 in expense) related to the November 11th fundraising above for 0.7 million shares of common stock. The $487,500 had been received as of March 3, 2006.

Clean Diesel has been unable to generate positive cash flows from its operations in the past. The Company does not have any credit facilities available with financial institutions or other third parties. If the Company is unable to generate cash flow from operations in the future, Clean Diesel will be dependent upon external sources of best-efforts financing, of which there are no firm commitments or arrangements. Based on the current operating plan, management believes that the cash balance as of June 30, 2006 of $2.5 million will be sufficient to meet the cash needs into the first quarter of 2007. In the future, unless operating revenues are sufficient to meet operating expenses, the Company may need to access capital markets to fund operations by incurring indebtedness or issuing equity securities. The Company can provide no assurance that it will be successful in any future financing effort to obtain the necessary working capital to support operations or if such financing is available, it will be on acceptable terms. If management is unable to obtain the necessary financing from external sources, the Company may need to manage any cash shortfalls by taking measures which may include deferring or reducing the scope of commercialization efforts, reducing costs and overhead expenses, or otherwise curtailing operations, or obtaining funds by a disposition of assets or through arrangements with others that may require Clean Diesel to relinquish rights to certain of its technologies, or to license the rights to such technologies on terms that are less favorable to Clean Diesel than might otherwise be available.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the opinion of management, with the exception of exposure to fluctuations in the cost of platinum and the British Sterling exchange rate, the Company is not subject to any significant market risk exposure.

The Company generally receives most income in United States dollars. Clean Diesel Technologies maintains a UK bank account and typically makes several payments monthly in various foreign currencies for patent expenses, product tests and registration, local marketing and promotion, consultants and employees.

ITEM 4. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures and internal controls designed to ensure that information required to be disclosed in the Company's filings under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and

forms. The Company's management, with the participation of its principal executive and financial officers, has 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 10Q. The Company's principal executive and financial officers have concluded, based on such evaluation, that such disclosure controls and procedures were effective for the purpose for which they were designed as of the end of such period.

There was no change in the Company's internal control over financial reporting that was identified in connection with such evaluation that occurred during the period covered by this Quarterly Report on form 10Q that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings
None

Item 1A Risk Factors

Item 2. Unregistered Sales of Securities and Use of Proceeds
None

Item 3. Defaults upon Senior Securities
None

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

At the June 15, 2006 Annual Meeting of Stockholders of CDT, the holders of 13,765,552 shares of CDT's common stock were present in person or by proxy. This attendance was, according to the records of CDT's Transfer Agent, 52.7% of the total of 26,100,268 shares outstanding as of the record date of May 5, 2006.

(i) the proposal to elect seven nominees as directors was approved by a vote with respect to each individuals, as follows:

Name	Shares For	Shares Withheld
John A. de Havilland	13,734,130	31,422
Derek R. Gray	13,760,763	4,789
Charles W. Grinnell	13,684,524	81,028
John J. McCloy, II	13,733,869	31,683
David F. Merrion	13,761,024	4,528
Jeremy D. Peter-Hoblyn	13,684,263	81,289
Bernard Steiner	13,733,980	31,572

(ii) the proposal to ratify the appointment of Eisner LLP as independent auditors of CDT for the year 2006 was approved by a vote of 13,663,424 for, 400 shares against and 1,728 abstentions.

(iii) the proposal to increase the authorized capital of CDT to 45,100,000 shares was approved by a vote of 13,490,619 for, 112,105 against and 162,828 abstentions.

Item 5. Other Information
None

Item 6. Exhibits
None

CLEAN DIESEL TECHNOLOGIES, INC.
SIGNATURES & CERTIFICATIONS

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.

Date: August 11, 2006	By: /s/Bernhard Steiner Bernhard Steiner Director, President and Chief Executive Officer
Date: August 11 2006	By: /s/David W. Whitwell David W. Whitwell Chief Financial Officer, Senior Vice President and Treasurer