

FUEL TECH, INC.  
Form 10-Q  
November 05, 2009

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2009**

**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: 001-33059**

**FUEL TECH, INC.**

(Exact name of registrant as specified in its charter)

Delaware

20-5657551

(State or other jurisdiction of incorporation of organization)

(I.R.S. Employer Identification Number)

Fuel Tech, Inc.  
27601 Bella Vista Parkway  
Warrenville, IL 60555-1617  
630-845-4500

(Address and telephone number of principal executive offices)

**Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.**

Yes  No

**Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in rule 12b-2 under the Securities Exchange Act of 1934).**

**Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer  Smaller Reporting Company**   
(Do not check if a smaller reporting company)

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

Yes  No

**As of October 27, 2009 there were outstanding 24,211,967 shares of Common Stock, par value \$0.01 per share, of the registrant.**

**FUEL TECH, INC.**  
Form 10-Q for the nine-month period ended September 30, 2009  
**INDEX**

|  | Page |
|--|------|
| <b><u>PART I. FINANCIAL INFORMATION</u></b>  |      |
| <b><u>Item 1. Financial Statements (Unaudited)</u></b>   |      |
| <u>Condensed Consolidated Balance Sheets as of September 30, 2009 and December 31, 2008</u>                                    | 1    |
| <u>Condensed Consolidated Statements of Operations for the Three- and Nine-Month Periods Ended September 30, 2009 and 2008</u> | 2    |
| <u>Condensed Consolidated Statements of Cash Flows for the Nine- Month Period Ended September 30, 2009 and 2008</u>            | 3    |
| <u>Notes to Condensed Consolidated Financial Statements</u>  | 4    |
| <b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>                    | 13   |
| <b><u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u></b>   | 16   |
| <b><u>Item 4. Controls and Procedures</u></b>  | 16   |
| <b><u>PART II. OTHER INFORMATION</u></b>   |      |
| <b><u>Item 1. Legal Proceedings</u></b>  | 17   |
| <b><u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u></b>  | 17   |
| <b><u>Item 3. Defaults upon Senior Securities</u></b>  | 17   |
| <b><u>Item 4. Submission of Matters to a Vote of Security Holders</u></b>  | 17   |
| <b><u>Item 5. Other Information</u></b>  | 17   |
| <b><u>Item 6. Exhibits</u></b>   | 18   |
| <b><u>SIGNATURES</u></b>   | 19   |
| <u>EX-4.1</u>  |      |
| <u>EX-4.2</u>  |      |
| <u>EX-4.3</u>  |      |
| <u>EX-10.1</u>   |      |
| <u>EX-10.2</u>   |      |
| <u>EX-10.3</u>   |      |
| <u>EX-10.4</u>   |      |
| <u>EX-10.5</u>   |      |
| <u>EX-10.6</u>   |      |
| <u>EX-10.7</u>   |      |
| <u>EX-31.1</u>   |      |

EX-31.2

EX-32

---

**Table of Contents****PART I. FINANCIAL INFORMATION**

## Item 1. Financial Statements

**FUEL TECH, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per-share data)

|  | September<br>30,<br>2009<br>(Unaudited) | December<br>31,<br>2008<br>(Note B) |
|--|---|-------------------------------------|
| <b>Assets</b>  |   |                                     |
| Current assets:  |   |                                     |
| Cash and cash equivalents  | \$ 13,203                               | \$ 28,149                           |
| Restricted cash  | 881                                     |                                     |
| Accounts receivable, net of allowance for doubtful accounts of \$69 and \$80, respectively                         | 20,184                                  | 23,365                              |
| Inventories  | 498                                     | 1,014                               |
| Deferred income taxes  | 767                                     | 767                                 |
| Prepaid expenses and other current assets  | 4,392                                   | 4,718                               |
| <b>Total current assets</b>  | <b>39,925</b>                           | <b>58,013</b>                       |
| Equipment, net of accumulated depreciation of \$14,595 and \$12,588, respectively                                  | 16,292                                  | 17,515                              |
| Goodwill   | 21,441                                  | 5,158                               |
| Other intangible assets, net of accumulated amortization of \$2,587 and \$1,504, respectively                      | 6,957                                   | 2,543                               |
| Deferred income taxes  | 4,025                                   | 2,412                               |
| Other assets   | 2,605                                   | 3,232                               |
| <b>Total assets</b>  | <b>\$ 91,245</b>                        | <b>\$ 88,873</b>                    |
| <b>Liabilities and Stockholders Equity</b>   |   |                                     |
| Current liabilities:   |   |                                     |
| Short-term debt  | \$ 2,194                                | \$ 2,188                            |
| Accounts payable   | 5,950                                   | 8,196                               |
| Accrued liabilities  | 3,851                                   | 3,283                               |
| <b>Total current liabilities</b>   | <b>11,995</b>                           | <b>13,667</b>                       |
| Other liabilities  | 2,954                                   | 1,389                               |
| <b>Total liabilities</b>   | <b>14,949</b>                           | <b>15,056</b>                       |
| Stockholders equity:   |   |                                     |
| Common stock, \$.01 par value, 40,000,000 shares authorized, 24,163,217 and 24,110,967 shares issued, respectively | 242                                     | 241                                 |

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|  |           |           |
|--|-----------|-----------|
| Additional paid-in capital                 | 123,530   | 118,588   |
| Accumulated deficit                        | (47,818)  | (45,280)  |
| Accumulated other comprehensive income     | 261       | 187       |
| Nil coupon perpetual loan notes            | 81        | 81        |
| Total stockholders' equity                 | 76,296    | 73,817    |
| Total liabilities and stockholders' equity | \$ 91,245 | \$ 88,873 |

See notes to condensed consolidated financial statements.

1

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**Table of Contents**

**FUEL TECH, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(Unaudited)  
(in thousands, except share and per-share data)

|  | Three Months Ended<br>September 30 |            | Nine Months Ended<br>September 30 |            |
|--|------------------------------------|------------|-----------------------------------|------------|
|  | 2009                               | 2008       | 2009                              | 2008       |
| <b>Revenues</b>  | \$ 16,475                          | \$ 23,703  | \$ 52,714                         | \$ 62,961  |
| <b>Costs and expenses:</b>                                   |                                    |            |                                   |            |
| Cost of sales  | 10,034                             | 13,019     | 31,786                            | 33,521     |
| Selling, general and administrative                          | 8,000                              | 6,789      | 25,130                            | 21,181     |
| Gain from revaluation of contingent performance obligation   | (781)                              |            | (781)                             |            |
| Research and development                                     | 160                                | 380        | 391                               | 1,844      |
|  | 17,413                             | 20,188     | 56,526                            | 56,546     |
| <b>Operating (loss) income</b>                               | (938)                              | 3,515      | (3,812)                           | 6,415      |
| Interest expense   | (27)                               | (31)       | (83)                              | (93)       |
| Interest income  | 7                                  | 145        | 30                                | 610        |
| Other expense  | (4)                                | (238)      | (166)                             | (154)      |
| <b>(Loss) income before taxes</b>                            | (962)                              | 3,391      | (4,031)                           | 6,778      |
| Income tax benefit (expense)                                 | 264                                | (1,289)    | 1,493                             | (2,596)    |
| <b>Net (loss) income</b>                                     | \$ (698)                           | \$ 2,102   | \$ (2,538)                        | \$ 4,182   |
| <b>Net (loss) income per Common Share:</b>                   |                                    |            |                                   |            |
| Basic  | \$ (0.03)                          | \$ 0.09    | \$ (0.11)                         | \$ 0.18    |
| Diluted  | \$ (0.03)                          | \$ 0.09    | \$ (0.11)                         | \$ 0.17    |
| <b>Weighted-average number of Common Shares outstanding:</b> |                                    |            |                                   |            |
| Basic  | 24,142,000                         | 23,978,000 | 24,127,000                        | 23,450,000 |
| Diluted  | 24,142,000                         | 24,638,000 | 24,127,000                        | 24,604,000 |

See notes to condensed consolidated financial statements.





**Table of Contents**

**FUEL TECH, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(in thousands)

|   | Nine Months Ended<br>September 30 |                  |
|---|-----------------------------------|------------------|
|   | 2009                              | 2008             |
| <b>Operating activities</b>                                 |                                   |                  |
| Net cash provided by operating activities                   | \$ 7,502                          | \$ 8,335         |
| <b>Investing activities</b>                                 |                                   |                  |
| Acquisition of business                                     | (20,186)                          |                  |
| Increase in restricted cash                                 | (881)                             |                  |
| Sales of short-term investments                             |                                   | 1,998            |
| Purchases of property, equipment and intangible assets      | (1,774)                           | (9,080)          |
| Net cash used in investing activities                       | (22,841)                          | (7,082)          |
| <b>Financing activities</b>                                 |                                   |                  |
| Proceeds from short-term borrowings                         | 5                                 | 137              |
| Issuance of deferred shares                                 | 63                                | 55               |
| Proceeds from exercise of stock options and warrants        | 251                               | 396              |
| Excess tax benefit for stock-based compensation             |                                   | 392              |
| Net cash provided by financing activities                   | 319                               | 980              |
| Effect of exchange rate fluctuations on cash                | 74                                | 74               |
| <b>Net (decrease) increase in cash and cash equivalents</b> | <b>(14,946)</b>                   | <b>2,307</b>     |
| Cash and cash equivalents at beginning of period            | 28,149                            | 30,473           |
| <b>Cash and cash equivalents at end of period</b>           | <b>\$ 13,203</b>                  | <b>\$ 32,780</b> |
| Supplemental disclosure of cash flow information:           |                                   |                  |
| Increase in contingent consideration payable                | \$ 1,526                          | \$               |
| Cash paid for interest                                      | \$ 47                             | \$ 94            |
| Cash paid for income taxes                                  | \$ 250                            | \$ 4,636         |
| See notes to condensed consolidated financial statements.   |                                   |                  |

3



**Table of Contents**

**FUEL TECH, INC.**  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
September 30, 2009  
(Unaudited)  
(in thousands, except share and per-share data)

***Note A: Nature of Business***

Fuel Tech, Inc. ( Fuel Tech or the Company ) is a fully integrated company that uses a suite of advanced technologies to provide boiler optimization, efficiency improvement and air pollution reduction and control solutions to utility and industrial customers worldwide. Originally incorporated in 1987 under the laws of the Netherlands Antilles as Fuel-Tech N.V., Fuel Tech became domesticated in the United States on September 30, 2006, and continues as a Delaware corporation with its corporate headquarters at 27601 Bella Vista Parkway, Warrenville, Illinois, 60555-1617. Fuel Tech maintains an Internet website at [www.ftek.com](http://www.ftek.com). Fuel Tech s annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934 are made available through its website as soon as reasonably practical after the Company electronically files or furnishes the reports to the Securities and Exchange Commission. Also available on the Company s website are the Company s Corporate Governance Guidelines and Code of Ethics and Business Conduct, as well as the charters of the Audit and Compensation & Nominating committees of the Board of Directors. All of these documents are available in print without charge to stockholders who request them. Information on Fuel Tech s website is not incorporated into this report.

Fuel Tech s special focus is the worldwide marketing of its nitrogen oxide (NOx) reduction and FUEL CHEM processes. The Air Pollution Control (APC) technology segment reduces NOx emissions in flue gas from boilers, incinerators, furnaces and other stationary combustion sources by utilizing combustion optimization techniques and Low-NOx and Ultra Low-NOx burners; over-fire air systems, NOxOUT<sup>®</sup> and HERT High Energy Reagent Technology SNCR systems; systems that incorporate NOxOUT CASCADE<sup>®</sup>, ULTRA and NOxOUT-SCR processes; and Ammonia Injection Grids (AIG) and the Graduated Straightening Grid (GSG). The FUEL CHEM technology segment improves the efficiency, reliability and environmental status of combustion units by controlling slagging, fouling and corrosion, as well as the formation of sulfur trioxide, ammonium bisulfate, particulate matter (PM<sub>2.5</sub>), carbon dioxide, NOx and unburned carbon in fly ash through the addition of chemicals into the fuel or via TIFI<sup>®</sup> Targeted In-Furnace Injection programs. Fuel Tech has other technologies, both commercially available and in the development stage, all of which are related to APC and FUEL CHEM processes or are similar in their technological base. Fuel Tech s business is materially dependent on the continued existence and enforcement of worldwide air quality regulations.

***Note B: 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 Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the balance sheet and results of operations for the periods covered have been included and all significant intercompany transactions and balances have been eliminated. The results of operations of all acquired businesses have been consolidated for all periods subsequent to the date of acquisition.

The balance sheet at December 31, 2008 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 Fuel Tech s Annual Report on Form 10-K for the year ended December 31, 2008 as filed with the Securities and Exchange Commission.

**Table of Contents*****Note C: Revenue Recognition Policy***

Revenues from the sales of chemical products are recorded when title transfers, either at the point of shipment or at the point of destination, depending on the contract with the customer. During a FUEL CHEM demonstration period, the Company will typically absorb all of the direct costs (e.g., chemicals, on-site personnel, equipment depreciation and demonstration-related travel expenses) and indirect costs of operating the demonstration and will offset these costs with partial billings to the customer. While each demonstration is unique, a typical demonstration will operate for 90 days and the Company will accumulate future billing amounts that will usually be invoiced to the customer only if the FUEL CHEM program converts to commercial status. These amounts may range from less than \$100 to over \$1,000 depending on the quantity of chemical fed, the agreed-upon cost sharing arrangement and the length of the demonstration program.

Fuel Tech uses the percentage of completion method of accounting for equipment construction and license contracts. Under the percentage of completion method, revenues are recognized as work is performed based on the relationship between actual construction costs incurred and total estimated costs at completion. Revisions in completion estimates and contract values in the period in which the facts giving rise to the revisions become known can influence the timing of when revenues are recognized under the percentage of completion method of accounting. Provisions are made for estimated losses on uncompleted contracts in the period in which such losses are determined. As of September 30, 2009 and December 31, 2008, the Company had no construction contracts in progress that were identified as loss contracts.

Accounts receivable includes unbilled receivables, representing revenues recognized in excess of billings on uncompleted contracts under the percentage of completion method of accounting. At September 30, 2009 and December 31, 2008, unbilled receivables on all projects were approximately \$7,197 and \$6,311, respectively. Such amounts are included in accounts receivable on the condensed consolidated balance sheets. Billings in excess of costs and estimated earnings on uncompleted contracts were \$1,354 and \$1,223 at September 30, 2009 and December 31, 2008, respectively. Such amounts are included in other accrued liabilities on the condensed consolidated balance sheets.

***Note D: Cost of Sales***

Cost of sales includes all internal and external engineering costs, equipment and chemical charges, inbound and outbound freight expenses, internal and site transfer costs, installation charges, purchasing and receiving costs, inspection costs, warehousing costs, project personnel travel expenses and other direct and indirect expenses specifically identified as project- or product line-related, as appropriate (e.g., test equipment depreciation and certain insurance expenses). Certain depreciation and amortization expenses related to tangible and intangible assets, respectively, are also allocated to cost of sales.

***Note E: Selling, General and Administrative Expenses***

Selling, general and administrative expenses primarily include the following categories except where an allocation to the cost of sales line item is warranted due to the project- or product-line nature of a portion of the expense category: salaries and wages, employee benefits, non-project travel, insurance, legal, rent, accounting and auditing, recruiting, telephony, employee training, Board of Directors fees, auto rental, office supplies, dues and subscriptions, utilities, real estate taxes, commissions and bonuses, marketing materials, postage and business taxes. Departments comprising the selling, general and administrative line item primarily include the functions of executive management, finance and accounting, investor relations, regulatory affairs, marketing, business development, information technology, human resources, sales, legal and general administration.

***Note F: Earnings per Share Data***

Basic earnings per share excludes the dilutive effects of stock options and warrants and of the nil coupon non-redeemable convertible unsecured loan notes. Diluted earnings per share includes the dilutive effect of stock options and warrants and of the nil coupon non-redeemable convertible unsecured loan notes. The following table sets forth the weighted-average shares used in calculating the earnings per share for the three- and nine-month periods ended September 30, 2009 and 2008:

**Table of Contents**

|                                    | Three Months Ended |        | Nine Months Ended |        |
|------------------------------------|--------------------|--------|-------------------|--------|
|                                    | September 30       |        | September 30      |        |
|                                    | 2009               | 2008   | 2009              | 2008   |
| Basic weighted-average shares      | 24,142             | 23,978 | 24,127            | 23,450 |
| Conversion of unsecured loan notes |                    | 45     |                   | 45     |
| Unexercised options and warrants   |                    | 615    |                   | 1,109  |
| Diluted weighted-average shares    | 24,142             | 24,638 | 24,127            | 24,604 |

**Note G: Total Comprehensive (Loss) Income**

Total comprehensive (loss) income for Fuel Tech is comprised of net (loss) income and the impact of foreign currency translation as follows:

|                              | Three Months Ended |          | Nine Months Ended |          |
|------------------------------|--------------------|----------|-------------------|----------|
|                              | September 30       |          | September 30      |          |
|                              | 2009               | 2008     | 2009              | 2008     |
| Comprehensive (loss) income: |                    |          |                   |          |
| Net (loss) income            | \$ (698)           | \$ 2,102 | \$ (2,538)        | \$ 4,182 |
| Foreign currency translation | 39                 | (35)     | 74                | 74       |
|                              | \$ (659)           | \$ 2,067 | \$ (2,464)        | \$ 4,256 |

**Note H: Stock-Based Compensation**

Fuel Tech has a stock-based employee compensation plan, referred to as the Fuel Tech, Inc. Incentive Plan ( Incentive Plan ), under which awards may be granted to participants in the form of Non-Qualified Stock Options, Incentive Stock Options, Stock Appreciation Rights, Restricted Stock, Performance Awards, Bonuses or other forms of share-based or non-share-based awards or combinations thereof. Participants in the Incentive Plan may be Fuel Tech's directors, officers, employees, consultants or advisors (except consultants or advisors in capital-raising transactions) as the directors determine are key to the success of Fuel Tech's business. The amount of shares that may be issued or reserved for awards to participants under a 2004 amendment to the Incentive Plan is 12.5% of outstanding shares calculated on a diluted basis. At September 30, 2009, Fuel Tech has 288,980 stock options available for issuance under the Incentive Plan.

Fuel Tech utilizes the Black-Scholes option-pricing model to estimate the fair value of stock option grants. The Company recorded stock-based compensation expense for the three- and nine-month periods ended September 30, 2009 of \$1,462 and \$4,628, respectively. Fuel Tech recorded \$1,525 and \$4,638 in stock-based compensation expense for the comparable periods in 2008.

The awards granted under the Incentive Plan have a 10-year life and they vest as follows: 50% after the second anniversary of the award date, 25% after the third anniversary, and the final 25% after the fourth anniversary of the award date. Fuel Tech calculates stock compensation expense based on the grant date fair value of the award and recognizes expense on a straight-line basis over the four-year service period of the award.

The principal variable assumptions utilized in valuing options and the methodology for estimating such model inputs include: (1) risk-free interest rate an estimate based on the yield of zero coupon treasury securities with a maturity equal to the expected life of the option; (2) expected volatility an estimate based on the historical volatility of Fuel Tech's Common Stock for a period equal to the expected life of the option; and (3) expected life of the option an estimate based on historical experience including the effect of employee terminations.

**Table of Contents**

Based on the results of the model, the weighted-average fair value of the stock options granted during the nine-month period ended September 30, 2009 was \$5.84 per share using the following assumptions:

|                         |             |
|-------------------------|-------------|
|                         | <b>2009</b> |
| Expected dividend yield | 0.00%       |
| Risk-free interest rate | 2.37%       |
| Expected volatility     | 67.6%       |
| Expected life of option | 5.2 years   |

Stock option activity for Fuel Tech's Incentive Plan for the nine months ended September 30, 2009 was as follows:

|                                   | <b>Number<br/>of<br/>Options</b> | <b>Weighted-<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|-----------------------------------|----------------------------------|---|---|--|
| Outstanding on January 1, 2009    | 2,905,325                        | \$ 16.30  |   |  |
| Granted                           | 505,000                          | 9.98  |   |  |
| Exercised                         | (52,250)                         | 4.82  |   | \$ 307                                   |
| Expired or forfeited              | (236,450)                        | 19.21   |   |  |
| Outstanding on September 30, 2009 | 3,121,625                        | \$ 15.25  | 7.2 years   | \$5,327                                  |
| Exercisable on September 30, 2009 | 1,586,250                        | \$ 13.37  | 6.1 years   | \$4,512                                  |

The weighted-average exercise price per non-vested stock award for all non-vested stock outstanding as of September 30, 2009 was \$17.20. Non-vested stock award activity for all plans for the nine months ended September 30, 2009 was as follows:

|                                   | <b>Non-vested<br/>Stock<br/>Outstanding</b> |
|-----------------------------------|---|
| Outstanding on January 1, 2009    | 1,443,625                                   |
| Granted                           | 505,000                                     |
| Released                          | (245,250)                                   |
| Expired or forfeited              | (168,000)                                   |
| Outstanding on September 30, 2009 | 1,535,375                                   |

As of September 30, 2009, there was \$9,384 of total unrecognized compensation cost related to non-vested stock-based compensation arrangements granted under the Incentive Plan. That cost is expected to be recognized over a period of four years.

In addition to the Incentive Plan, Fuel Tech has a Deferred Compensation Plan for Directors (Deferred Plan). This Deferred Plan, as originally approved, provided for deferral of directors' fees in the form of either cash with interest or as phantom stock units, in either case, however, to be paid out only as cash and not as stock at the elected time of payout. In the second quarter of 2007, Fuel Tech obtained stockholder approval for an amendment to the Deferred Plan to provide that instead of phantom stock units paid out only in cash, the deferred stock unit compensation may be paid out in shares of Fuel Tech Common Stock. Under the guidance of ASC 718-10, this plan modification required that Fuel Tech account for awards under the plan for the receipt of Fuel Tech Common Stock, as equity awards as opposed to liability awards. For the nine months ended September 30, 2009, Fuel Tech recorded stock-based

compensation expense of \$63 with a credit of the same amount to additional paid-in capital representing the fair value of the stock awards granted.

**Table of Contents*****Note I: Debt***

On June 30, 2009, Fuel Tech entered into a \$25,000 revolving credit facility (the Facility) with JPMorgan Chase Bank, N.A. (JPM Chase). The Facility has a term of two years through June 30, 2011, is unsecured, bears interest at a rate of LIBOR plus a spread range of 250 basis points to 300 basis points, as determined under a formula related to the Company's leverage ratio, and has the Company's Italian subsidiary, Fuel Tech S.r.l., as a guarantor. Fuel Tech can use this Facility for cash advances and standby letters of credit. As of September 30, 2009, there were no outstanding borrowings on this Facility. The Credit Agreement dated as of June 30, 2009 by and between Fuel Tech, Inc. and JPM Chase and the Revolving Credit Note dated June 30, 2009 from Fuel Tech, Inc. to JPM Chase were included in their entirety as exhibits to the Company's Form 8-K filed with the Securities and Exchange Commission on July 2, 2009. The Company's prior facility with Wachovia Bank, N.A. was terminated on June 30, 2009.

At its inception, the Facility contained several debt covenants with which the Company must comply on a quarterly or annual basis, including: an annual capital expenditure limit of \$10,000 and a minimum net income for the quarterly period ended September 30, 2009 of \$750. For subsequent periods, the Facility covenants included a maximum funded debt to EBITDA ratio of 2.0:1.0 for the quarterly period ended December 31, 2009 and a maximum funded debt to EBITDA ratio of 1.5:1.0 for all succeeding quarterly periods until the facility expires. Maximum funded debt is defined as all borrowed funds, outstanding standby letters of credit and bank guarantees. EBITDA includes after tax earnings with add backs for interest expense, income taxes, and depreciation and amortization expenses. In addition, the Company must maintain a minimum tangible net worth of \$42,000, adjusted upward for 50% of net income generated and 100% of all capital issuances.

As of and for the three-month period ended September 30, 2009, except for the required minimum quarterly net income covenant of \$750, the Company was in compliance with all debt covenants of the Facility, including a year-to-date capital expenditure amount of \$1,774 and a tangible net worth of \$47,898 versus a required amount of 45,533. Due to the Company's quarterly net loss of (\$698), the required minimum quarterly net income of \$750 was not achieved. The Company has obtained a waiver of this covenant breach from JPM Chase for the quarterly period ended September 30, 2009 and has revised certain financial covenants as follows: for the three-month period ended December 31, 2009 the Company shall achieve a Minimum Net Income of (\$2,000), and for the three-month period ended March 31, 2010 the Company's Leverage Ratio shall not exceed 2.75:1.0. The purchase price for allowable Acquisitions made during any fiscal year was also lowered to \$5,000 in the aggregate if the Leverage Ratio is greater than 2.75:1.0. No other Facility covenants were modified for any other period. The Company's spread matrix for fees paid on items such as standby letters of credit was adjusted upward to include additional tiers tied to the quarterly calculated Leverage Ratio. These modifications are included in the Second Amendment to the Credit Agreement filed as an attachment to this Quarterly Report on Form 10-Q.

Beijing Fuel Tech Environmental Technologies Company, Ltd. (Beijing Fuel Tech), a wholly-owned subsidiary of Fuel Tech, has a revolving credit facility (the China Facility) agreement with JPM Chase for RMB 35 million (approximately \$5,000), which expires on June 30, 2010. The facility is unsecured, bears interest at a rate of 120% of the People's Bank of China (PBOC) Base Rate and does not contain any material debt covenants. Beijing Fuel Tech can use this facility for cash advances and bank guarantees. As of September 30, 2009, Beijing Fuel Tech has borrowings outstanding in the amount \$2,194, which bear interest at 5.8%.

In the event of default on either the Facility or the China Facility, the cross default feature in each allows the lending bank to accelerate the payment of any amounts outstanding and may, under certain circumstances, allow the bank to cancel the facility. If the Company were unable to obtain a waiver for a breach of covenant and the bank accelerated the payment of any outstanding amounts, such acceleration may cause the Company's cash position to deteriorate or, if cash on hand were insufficient to satisfy the payment due, may require the Company to obtain alternate financing to satisfy the accelerated payment.

***Note J: Business Segment and Geographic Disclosures***

Fuel Tech segregates its financial results into two reportable segments representing two broad technology segments as follows:

The Air Pollution Control technology segment, which includes the Low- and Ultra-low NOx Burners, over-fire air systems, HERT systems, NOxOUT®, NOxOUT CASCADE®, AIG, GSG, ULTRA and NOxOUT-SCR®



processes, for the reduction of NOx emissions in flue gas from boilers, incinerators, furnaces and other stationary combustion sources; and

**Table of Contents**

The FUEL CHEM<sup>®</sup> technology segment, which uses chemical processes for the control of slagging, fouling, corrosion, opacity, acid plume and sulfur trioxide-related issues in furnaces and boilers through the addition of chemicals into the furnace using TIFI<sup>®</sup> Targeted In-Furnace Injection technology.

Fuel Tech evaluates performance and allocates resources based on reviewing gross margin by reportable segment. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Fuel Tech does not review assets by reportable segment, but rather, in aggregate for Fuel Tech as a whole. Reporting segment revenues and gross margin are provided below. The Other classification includes those profit and loss items not allocated by Fuel Tech to each reportable segment. There are no intersegment sales that require elimination.

| Three months ended   | Air Pollution | FUEL      |            |           |
|--|---------------|-----------|------------|-----------|
| September 30, 2009   | Control       | CHEM      | Other      | Total     |
|  | Segment       | Segment   |            |           |
| Revenues from external customers                           | \$ 6,182      | \$ 10,293 | \$         | \$ 16,475 |
| Cost of sales  | 4,089         | 5,945     |            | 10,034    |
| Gross margin   | 2,093         | 4,348     |            | 6,441     |
| Selling, general and administrative                        |               |           | 8,000      | 8,000     |
| Gain from revaluation of contingent performance obligation |               |           | (781)      | (781)     |
| Research and development                                   |               |           | 160        | 160       |
| Operating income (loss)                                    | \$ 2,093      | \$ 4,348  | \$ (7,379) | \$ (938)  |

| Three months ended                  | Air Pollution | FUEL      |            |           |
|-------------------------------------|---------------|-----------|------------|-----------|
| September 30, 2008                  | Control       | CHEM      | Other      | Total     |
|                                     | Segment       | Segment   |            |           |
| Revenues from external customers    | \$ 13,567     | \$ 10,136 | \$         | \$ 23,703 |
| Cost of sales                       | 7,704         | 5,315     |            | 13,019    |
| Gross margin                        | 5,863         | 4,821     |            | 10,684    |
| Selling, general and administrative |               |           | 6,789      | 6,789     |
| Research and development            |               |           | 380        | 380       |
| Operating income (loss)             | \$ 5,863      | \$ 4,821  | \$ (7,169) | \$ 3,515  |

| Nine months ended  | Air Pollution | FUEL      |        |           |
|--|---------------|-----------|--------|-----------|
| September 30, 2009   | Control       | CHEM      | Other  | Total     |
|  | Segment       | Segment   |        |           |
| Revenues from external customers                           | \$ 24,179     | \$ 28,535 | \$     | \$ 52,714 |
| Cost of sales  | 15,096        | 16,690    |        | 31,786    |
| Gross margin   | 9,083         | 11,845    |        | 20,928    |
| Selling, general and administrative                        |               |           | 25,130 | 25,130    |
| Gain from revaluation of contingent performance obligation |               |           | (781)  | (781)     |
| Research and development                                   |               |           | 391    | 391       |

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Operating income (loss) \$ 9,083 \$ 11,845 \$ (24,740) \$ (3,812)

| Nine months ended<br>September 30, 2008 | FUEL<br>CHEM                        |           | Other       | Total     |
|---|-------------------------------------|-----------|-------------|-----------|
|   | Air Pollution<br>Control<br>Segment | Segment   |             |           |
| Revenues from external customers        | \$ 35,713                           | \$ 27,248 | \$          | \$ 62,961 |
| Cost of sales                           | 19,507                              | 14,013    | 1           | 33,521    |
| Gross margin                            | 16,206                              | 13,235    | (1)         | 29,440    |
| Selling, general and administrative     |                                     |           | 21,181      | 21,181    |
| Research and development                |                                     |           | 1,844       | 1,844     |
| Operating income (loss)                 | \$ 16,206                           | \$ 13,235 | \$ (23,026) | \$ 6,415  |

9

**Table of Contents**

Information concerning Fuel Tech's operations by geographic area is provided below. Revenues are attributed to countries based on the location of the customer. Assets are those directly associated with operations of the geographic area.

|               | Three months ended<br>September 30 |           | Nine months ended<br>September 30 |                         |
|---------------|------------------------------------|-----------|-----------------------------------|-------------------------|
|               | 2009                               | 2008      | 2009                              | 2008                    |
| Revenues:     |                                    |           |                                   |                         |
| United States | \$ 14,054                          | \$ 19,319 | \$ 43,114                         | \$ 54,845               |
| Foreign       | 2,421                              | 4,384     | 9,600                             | 8,116                   |
|               | \$ 16,475                          | \$ 23,703 | \$ 52,714                         | \$ 62,961               |
|               |                                    |           | September<br>30,<br>2009          | December<br>31,<br>2008 |
| Assets:       |                                    |           |                                   |                         |
| United States |                                    |           | \$ 82,532                         | \$ 81,241               |
| Foreign       |                                    |           | 8,713                             | 7,632                   |
|               |                                    |           | \$ 91,245                         | \$ 88,873               |

**Note K: Contingencies**

Fuel Tech issues a standard product warranty with the sale of its products to customers. Fuel Tech's recognition of warranty liability is based primarily on analyses of warranty claims experienced in the preceding years as the nature of our historical product sales for which we offer a warranty are substantially unchanged. This approach has proven to provide an aggregate warranty accrual that is historically aligned with actual warranty claims experienced. Changes in the warranty liability for the nine months ended September 30, 2009 are summarized below:

|  |        |
|--|--------|
| Aggregate product warranty liability at January 1, 2009    | \$ 265 |
| Aggregate accruals related to product warranties           | 90     |
| Aggregate reductions for payments                          | (151)  |
| Aggregate product warranty liability at September 30, 2009 | \$ 204 |

**Note L: Income Tax**

Fuel Tech had unrecognized tax benefits as of December 31, 2008 in the amount of \$781. This amount included \$747 of unrecognized tax benefits which, if ultimately recognized, will reduce Fuel Tech's annual effective tax rate. There have been no material changes in unrecognized tax benefits during the quarter ended September 30, 2009.

**Note M: Recently Adopted Accounting Pronouncements**

In June 2009, the Financial Accounting Standards Board (FASB) issued authoritative guidance establishing two levels of U.S. generally accepted accounting principles (GAAP) authoritative and non-authoritative and making the Accounting Standards Codification (ASC) the source of authoritative, non-governmental GAAP, except for rules and interpretive releases of the Securities and Exchange Commission. This guidance, which was incorporated into Accounting Standards Codification Topic 105, Generally Accepted Accounting Principles, was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption changed certain disclosure references to U.S. GAAP, but did not have any other effect on the Company's consolidated financial statements.



**Table of Contents**

In June 2009, the FASB issued revised authoritative guidance related to variable interest entities (VIE), which requires entities to perform a qualitative analysis to determine whether a variable interest gives the entity a controlling financial interest in a VIE. The guidance also requires an ongoing reassessment of variable interests and eliminates the quantitative approach previously required for determining whether an entity is the primary beneficiary. This guidance, which was incorporated into ASC Topic 810, Consolidation, will be effective as of the beginning of an entity's first annual reporting period that begins after November 15, 2009 (January 1, 2010 for the Company). The Company does not expect the adoption to have a material effect on its consolidated financial statements.

In May 2009, the FASB issued authoritative guidance establishing general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. This guidance, which was incorporated into ASC Topic 855, Subsequent Events, was effective for interim or annual financial periods ending after June 15, 2009, and the adoption did not have any impact on the Company's consolidated financial statements.

In April 2009, the FASB issued updated guidance related to business combinations, which is included in the Codification in ASC 805-20, Business Combinations—Identifiable Assets, Liabilities and Any Non-controlling Interest. ASC 805-20 amends the provisions in ASC 805 for the initial recognition and measurement, subsequent measurement and accounting, and disclosures for assets and liabilities arising from contingencies in business combinations. ASC 805-20 is effective for contingent assets or contingent liabilities acquired in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The implementation of this standard did not have a material effect on the Company's consolidated financial statements.

***Note N: Business Acquisitions***

Fuel Tech accounts for its acquisitions as purchases in accordance with ASC 805-20. Accordingly, in connection with each acquisition, the purchase price is allocated to the estimated fair values of all acquired tangible and intangible assets and assumed liabilities as of the date of the acquisition.

***Advanced Combustion Technology, Inc.***

On January 5, 2009, Fuel Tech completed its acquisition of substantially all of the assets of Advanced Combustion Technology, Inc. (ACT or the ACT Acquisition) for approximately \$22,500 in cash, including transaction costs, plus future consideration if certain financial performance is achieved. In connection with the final determination of the Adjustment Calculation (as defined in the asset purchase agreement) related to the net working capital amount, Fuel Tech paid ACT an additional \$1,523 on July 23, 2009. All of the goodwill recognized is expected to be deductible for income tax purposes. Operating results related to the acquisition of substantially all of the assets of ACT and all of the related goodwill are reported as part of the APC Technology segment. Acquisition related costs, including out-of-pocket expenses related to the transaction, were insignificant.

At March 31, 2009, the Company recorded a contingent consideration accrual representing the fair value, weighted-average probability of future consideration expected to be paid in connection with the acquisition of substantially all of the assets of ACT of \$2,307. The contingent consideration arrangement requires the Company to pay ACT a pro rata amount of up to \$4,000 annually for the achievement of a minimum annual gross margin dollar level (the Hurdle) of \$10,000, \$11,000 and \$12,000 in fiscal 2009, 2010 and 2011, respectively. In addition, the Company is required to pay ACT thirty-five percent (35%) of all qualifying gross margin dollars above the annual Hurdle rate for each of the three years. The potential undiscounted amount of all future payments that the Company could be required to make under the contingent consideration arrangement is between \$0 and \$4,000 in any one year, and \$0 and \$12,000 in total, not including the amount related to the thirty-five percent (35%) sharing of qualifying gross margin dollars above the pre-determined Hurdle. The fair value of the contingent consideration arrangement of \$2,307 was calculated using a probability of payout for each of the three years and included only twenty-five percent (25%) of the weighted-average, probable three-year aggregate payout as up to seventy-five percent (75%) of the contingent consideration is subject to forfeiture.

As of September 30, 2009, the amount recognized for the contingent consideration arrangement, the range of outcomes, and assumptions used to develop the estimates have changed for fiscal 2009. Management concluded that a fiscal 2009 earnout payment related to the ACT Acquisition is not probable. Thus, the Company recorded a one-time gain of \$781 from the revaluation of the contingent liability.

As a result of the previously-announced acquisitions of substantially all of the assets of ACT in the first quarter of 2009, and Tackticks, LLC (Tackticks) and FlowTack, LLC (FlowTack) in the fourth quarter of 2008, the Company's condensed

**Table of Contents**

consolidated results for the periods presented are not directly comparable. Pro forma results of operations for the three- and nine-month periods ended September 30, 2009 and 2008, which assumes the acquisitions were completed on January 1, 2008, are as follows:

|                                     | Three months ended September<br>30 |            |
|-------------------------------------|------------------------------------|------------|
|                                     | 2009                               | 2008       |
| Revenues                            | \$ 16,475                          | \$ 43,856  |
| Net (loss) income                   | (\$698)                            | \$ 4,471   |
| Net (loss) income per Common Share: |                                    |            |
| Basic                               | (\$0.03)                           | \$ 0.19    |
| Diluted                             | (\$0.03)                           | \$ 0.18    |
|                                     | Nine months ended September 30     |            |
|                                     | 2009                               | 2008       |
| Revenues                            | \$ 52,714                          | \$ 106,152 |
| Net (loss) income                   | (\$2,538)                          | \$ 9,809   |
| Net (loss) income per Common Share: |                                    |            |
| Basic                               | (\$0.11)                           | \$ 0.42    |
| Diluted                             | (\$0.11)                           | \$ 0.40    |

Operating results for the acquired assets are included in the Company's consolidated statements of income from the date of acquisition.

**Note O: Goodwill**

Goodwill is allocated among and evaluated for impairment at the reporting unit level, which is defined as an operating segment or one level below an operating segment. Fuel Tech has two reporting units which are reported in the FUEL CHEM segment and the APC Technology segment. As of September 30, 2009 and December 31, 2008, goodwill allocated to the FUEL CHEM Technology segment was \$1,723 and \$1,723, respectively, while goodwill allocated to the APC Technology segment was \$19,718 and \$3,435, respectively. The \$16,283 increase in goodwill allocated to the APC Technology segment from December 31, 2008 is attributable to goodwill from the acquisition of substantially all of the assets of Advanced Combustion Technology, Inc. on January 5, 2009.



**Table of Contents****FUEL TECH, INC.****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations*****Results of Operations***

Revenues for the three months ended September 30, 2009 and 2008 were \$16,475 and \$23,703, respectively, while revenues for the nine months ended September 30, 2009 and 2008 were \$52,714 and \$62,961, respectively. The decreases in consolidated revenues versus the prior year, for both the quarterly and year-to-date periods, are primarily driven by suppressed domestic Air Pollution Control (APC) technology segment orders which led to the APC segment revenue shortfall.

The APC technology segment generated revenues of \$6,182 and \$24,179 for the three- and nine-month periods ended September 30, 2009, respectively, a decrease of \$7,385, or 54%, and \$11,534, or 32%, from the respective prior year periods due to an across-the-board slowdown of capital project orders for pollution control equipment from our customer base. While revenues are down from the prior year, this segment remains uniquely positioned to capitalize on the next phase of increasingly stringent U.S. and Chinese air quality standards, specifically on NOx control. Interest in Fuel Tech's suite of pollution control technologies, on both a new and retrofit basis, remains strong, both domestically and abroad, and recent quotation and order activity has been strong.

The FUEL CHEM technology segment generated revenues of \$10,293 and \$28,535 for the three- and nine-month periods ended September 30, 2009, respectively, an increase of \$157, or 2%, and \$1,287, or 5%, versus the respective prior year periods. This increase is primarily due to the addition of new customer units and increased project demonstrations activity. The Company recently announced the addition of several new international commercial contracts, further strengthening its global presence in the marketplace. Despite a record level of year-to-date revenues through September 30, 2009, the recent decrease in demand for electricity, largely related to the economic recession, has dictated that certain Fuel Tech customers shut down or scale back certain boiler operations. This, in turn, has resulted in certain FUEL CHEM programs being operated at reduced levels or, in some cases, being temporarily turned off. Even with the near-term economic environment, the marketplace acceptance for Fuel Tech's patented TIF® Targeted In-Furnace Injection technology remains strong, both domestically and abroad, particularly on coal-fired units, which represent the largest market opportunity for the technology.

The FUEL CHEM technology segment revolves around the unique application of specialty chemicals to improve the efficiency, reliability and environmental status of plants operating in the electric utility, industrial, pulp and paper, and waste-to-energy markets. FUEL CHEM programs are currently commercial on over 75 combustion units around the world, treating a wide variety of solid and liquid fuels, including coal, heavy oil, biomass and municipal waste. Cost of sales as a percentage of revenue for the three months ended September 30, 2009 and 2008 was 61% and 55%, respectively. The quarterly cost of sales percentage for the APC technology segment increased to 66% from 57% in the comparable prior-year period, primarily due to a pass-through product sale at a nominal gross margin percentage whereby Fuel Tech was acting as a conduit for the catalyst manufacturer and the timing of project milestones for other contracts that primarily involved lower margin revenue-generating activities supporting APC projects.

For the FUEL CHEM technology segment, the quarterly cost of sales percentage increased to 58% from 52% for the comparable prior-year quarter. This increase was primarily due to demonstration program expenses as the Company continues to run a substantial number of domestic demonstrations, the one-time sale of FUEL CHEM equipment at a nominal price to support the start up of a Mexican-based FUEL CHEM program, and the continued suppressed average revenue base at many existing customers that dilutes customer-specific gross margins as local fixed costs remain in spite of the decreased revenue amount.

Cost of sales as a percentage of revenue for the nine months ended September 30, 2009 and 2008 was 60% and 53%, respectively. The cost of sales percentage for the APC technology segment increased to 62% from 55% due primarily to the pass-through product sales of several items at a nominal gross margin percentage whereby Fuel Tech was acting as a conduit for the catalyst manufacture and project timing which resulted in a higher-than-average project mix towards other lower margin revenue-generating activities supporting APC projects.

For the FUEL CHEM technology segment, the cost of sales percentage increased to 59% from 51% for the comparable prior-year quarter. This increase was primarily due to demonstration program expenses as the Company continues to run several



**Table of Contents**

international and domestic demonstrations, the one-time sale of FUEL CHEM equipment at a nominal price to support the start up of a Mexican-based FUEL CHEM program, and the continued suppressed average revenue base at many existing customers that dilutes customer-specific gross margins as local fixed costs remain in spite of the decreased revenue amount.

Selling, general and administrative (SG&A) expenses for the three-month period ended September 30, 2009 were \$8,000, an increase of \$1,211, or 18%, versus the comparable prior year period. The increase was driven by additional sales commissions, primarily associated with record FUEL CHEM sales, of \$544 as the sales commission plan became effective January 1, 2009, salaries and benefits of \$496 primarily related to the October 2008 acquisition of substantially all of the assets of Tackticks and FlowTack and the January 2009 ACT Acquisition, lower than expected utilization of engineering personnel of \$303, additional legal expenses of \$223 for general corporate administrative matters, including contract review and intellectual property-related work, increased personnel-related costs of \$162 in the Company's Beijing office to support growth, and increased depreciation expense of \$102 related to additional FUEL CHEM equipment deployed at customer sites. Partially offsetting these increases were reduced expenditures for consultants of \$243, lower third-party agency commissions for APC sales of \$175 related to suppressed year-to-date APC customer orders, and lower personnel recruiting costs of \$124.

SG&A expenses for the nine-month period ended September 30, 2009 were \$25,130, an increase of \$3,949, or 19%, versus the comparable prior year period. The increase was driven by additional salaries and benefits of \$2,670 primarily related to the October 2008 acquisition of substantially all of the assets of Tackticks and FlowTack and the January 2009 ACT Acquisition and a one-time employee expense of \$550 related to the reduction in workforce the Company undertook during the second quarter of 2009, increased sales commissions, primarily associated with record FUEL CHEM sales, of \$864 as the sales commission plan became effective January 1, 2009, increased depreciation expense of \$348 related to additional FUEL CHEM equipment deployed at customer sites, increased personnel-related costs of \$232 in the Company's Beijing office to support growth, lower than expected utilization of engineering personnel of \$185, increased service fees for computer modeling software of \$142, additional travel costs of \$128 to support international and domestic growth, and additional legal expenses of \$118 for general corporate administrative matters, including contract review and intellectual property-related work. Partially offsetting these increases are reduced personnel recruiting costs of \$319, lower third-party agency commissions for APC sales of \$296 related to suppressed year-to-date APC customer orders, and reduced expenditures for consultants of \$206.

The Company recorded a one-time gain of \$781 from the revaluation of the contingent liability recorded in connection with the ACT Acquisition in January 2009. The \$781 had been recorded in the first quarter of 2009 as part of a \$2,307 contingent consideration accrual representing the fair value, weighted-average probability of future consideration expected to be paid in connection with the ACT Acquisition. For the year ended December 31, 2009, management has concluded that an earnout payment related to the ACT Acquisition for fiscal 2009 is not probable, thus the \$781 portion of the total contingent liability that related to 2009 was reversed.

Research and development (R&D) expenses for the three months ended September 30, 2009 were \$160, a decrease of \$220, or 58%, versus the comparable prior-year period, while R&D expenditures for the nine months ended September 30, 2009 were \$391, a decrease of \$1,453, or 78%, versus the comparable prior-year period. Both the three- and nine-month year-over-year declines in R&D expenditures are due to the Company moderating its near-term R&D expenditures in the wake of the global financial crisis and revenue shortfalls. However, Fuel Tech has maintained its focused approach in the pursuit of commercial applications for its technologies outside of its traditional markets, and in the development and analysis of new technologies that could represent incremental market opportunities.

Interest income for the three- and nine-month periods ended September 30, 2009 of \$7 and \$30, respectively, decreased \$138, or 95%, and \$580, or 95%, respectively. The primary drivers of the reduced levels of interest income for both periods are a significant reduction in cash and cash equivalents on hand due to the cash outlay for the acquisitions of substantially all of the assets of Tackticks FlowTack, and ACT, coupled with a decrease in the average return in the Company's interest-bearing accounts in which the cash is invested.

Income tax benefit / (expense) for the three- and nine-month periods ended September 30, 2009 and 2008 were \$264 and (\$1,289) and \$1,493 and (\$2,596), respectively, reflecting the Company's pre-tax loss and income positions,

respectively.

**Table of Contents*****Liquidity and Sources of Capital***

At September 30, 2009, Fuel Tech had cash and cash equivalents, short-term investments and restricted cash on hand of \$14,084 and working capital of \$27,930 versus \$28,149 and \$44,346 at December 31, 2008, respectively.

Restricted cash as of September 30, 2009 of \$881 was used as collateral for pre-existing stand-by letters of credit and bank guaranties with Wachovia Bank, N.A. (Wachovia) at June 30, 2009 as that was the date the Company entered into a new revolving credit facility with JPMorgan Chase N.A. (JPM Chase). As these instruments are transferred to JPM Chase and the Wachovia instruments are retired, the cash collateral will no longer be needed and will cease to be restricted. The reduction in restricted cash from the June 30, 2009 balance of \$5,525 is reflective of the transfer of most of the stand-by letters of credit and bank guaranties out of Wachovia to JPM Chase.

Operating activities provided \$7,502 of cash during the nine-month period ended September 30, 2009, primarily due to the add back of non-cash items, including depreciation of \$2,842, amortization of \$1,082, and stock compensation expense of \$4,628, an increase in accrued liabilities of \$610 and decreases in asset accounts, including accounts receivable of \$3,181, inventory of \$517 and prepaid expenses of \$907. Partially offsetting these positive cash flow items were the year-to-date net loss of \$2,538, an income tax benefit of \$1,613 and a decrease in accounts payable of \$2,245.

Investing activities used cash of \$22,841 during the nine-month period ended September 30, 2009. This amount was comprised of three items: the acquisition of substantially all of the assets of ACT required a total funding of \$20,186; capital expenditures of \$1,774, primarily to support and enhance the operations of the FUEL CHEM technology segment; and an increase in restricted cash of \$881 to support the transfer of pre-existing stand-by letters of credit and bank guaranties from Wachovia to JPM Chase.

The Company generated cash from financing activities during the nine-month period ended September 30, 2009 of \$319, primarily from the excess tax benefits realized of \$251 from stock options exercised in the first nine months of 2009 and from the issuance of directors' deferred shares of stock of \$63.

***Contingencies and Contractual Obligations***

Fuel Tech issues a standard product warranty with the sale of its products to customers as discussed in Note K. The change in the warranty liability balance during the three months ended September 30, 2009 was not material.

***Forward-Looking Statements***

This Quarterly Report on Form 10-Q contains forward-looking statements, as defined in Section 21E of the Securities Exchange Act of 1934, as amended, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and reflect Fuel Tech's current expectations regarding future growth, results of operations, cash flows, performance and business prospects, and opportunities, as well as assumptions made by, and information currently available to, our management. Fuel Tech has tried to identify forward-looking statements by using words such as anticipate, believe, plan, expect, estimate, intend, will, and similar expressions, but they are not the exclusive means of identifying forward-looking statements. These statements are based on information currently available to Fuel Tech and are subject to various risks, uncertainties, and other factors, including, but not limited to, those discussed in Fuel Tech's Annual Report on Form 10-K for the year ended December 31, 2008 in Item 1A under the caption Risk Factors, which could cause Fuel Tech's actual growth, results of operations, financial condition, cash flows, performance and business prospects and opportunities to differ materially from those expressed in, or implied by, these statements. Fuel Tech undertakes no obligation to update such factors or to publicly announce the results of any of the forward-looking statements contained herein to reflect future events, developments, or changed circumstances or for any other reason. Investors are cautioned that all forward-looking statements involve risks and uncertainties, including those detailed in Fuel Tech's filings with the Securities and Exchange Commission.

**Table of Contents**

Item 3. Quantitative and Qualitative Disclosures about Market Risk

***Foreign Currency Risk Management***

Fuel Tech's earnings and cash flow are subject to fluctuations due to changes in foreign currency exchange rates. We do not enter into foreign currency forward contracts nor into foreign currency option contracts to manage this risk due to the immaterial nature of the transactions involved.

Fuel Tech is also exposed to changes in interest rates primarily due to its long-term debt arrangement (refer to Note I to the consolidated financial statements). A hypothetical 100 basis point adverse move in interest rates along the entire interest rate yield curve would not have a materially adverse effect on interest expense during the upcoming year ended December 31, 2009.

Item 4. Controls and Procedures

Fuel Tech maintains disclosure controls and procedures and internal controls designed to ensure (a) that information required to be disclosed in Fuel Tech'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, and (b) that such information is accumulated and communicated to management, including the principal executive and financial officer, as appropriate to allow timely decisions regarding required disclosure. Fuel Tech's management, with the participation of its principal executive and financial officers, has evaluated the effectiveness of Fuel Tech's disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Fuel Tech's principal executive and financial officers have concluded, based on such evaluation, that such disclosure controls and procedures were effective as of the end of such period.

There was no change in Fuel Tech'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 10-Q that has materially affected, or is reasonably likely to materially affect, Fuel Tech's internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

Item 1. Legal Proceedings

None

Item 1A. Risk Factors

THE COMPANY HAS NEEDED TO OBTAIN A WAIVER FROM ITS U.S. LENDER FOR A COVENANT VIOLATION DUE TO LESS THAN ANTICIPATED OPERATING RESULTS.

In the event of default on the domestic Facility, the lending bank may accelerate the payment of any amounts outstanding and may, under certain circumstances, cancel the facility. If the Company were unable to obtain a waiver for a breach of covenant and the bank accelerated the payment of any outstanding amounts, such acceleration may cause the Company's cash position to deteriorate or, if cash on hand were insufficient to satisfy the payment due, may require the Company to obtain alternate financing to satisfy the accelerated payment.

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

None

Item 3. Defaults upon Senior Securities

None

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

None

Item 5. Other Information

None

**Table of Contents**

Item 6. Exhibits

- a. Exhibits (all filed herewith)
  - 4.1 Instrument Constituting US \$19,200 Nil Coupon Non-Redeemable Convertible Unsecured Loan Notes of Fuel-Tech N.V., dated December 21, 1989.
  - 4.2 First Supplemental Instrument Constituting US \$3,000 Nil Coupon Non-Redeemable Convertible Unsecured Loan Notes of Fuel-Tech N.V., dated July 10, 1990.
  - 4.3 Instrument Constituting US \$6,000 Nil Coupon Non-Redeemable Convertible Unsecured Loan Notes of Fuel-Tech N.V., dated March 12, 1993
  - 10.1 Employment Agreement, dated April 30, 2008, between John P. Graham and Fuel Tech, Inc.
  - 10.2 Employment Agreement, dated February 1, 1998, between Stephen P. Brady and Fuel Tech, Inc.
  - 10.3 Employment Agreement, dated October 2, 2008, between Volker Rummenhohl and Fuel Tech, Inc.
  - 10.4 Sublease Agreement, dated January 29, 2004, between American Bailey Corporation and Fuel Tech, Inc.
  - 10.5 Credit Agreement dated as of June 30, 2009 by and between Fuel Tech, Inc. and JPMorgan Chase Bank, N.A. including exhibits and schedules
  - 10.6 First Amendment to Credit Agreement dated as of October 5, 2009 by and between Fuel Tech, Inc. and JPMorgan Chase Bank, N.A.
  - 10.7 Second Amendment to Credit Agreement dated as of November 4, 2009 by and between Fuel Tech, Inc. and JPMorgan Chase Bank, N.A.
  - 31.1 Certification of CEO pursuant to Section 302 of Sarbanes-Oxley Act of 2002
  - 31.2 Certification of CFO pursuant to Section 302 of Sarbanes-Oxley Act of 2002
  - 32 Certification of CEO and CFO pursuant to Section 906 of Sarbanes-Oxley Act of 2002



**Table of Contents**

**FUEL TECH, INC.**

**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.

Date: November 5, 2009

By: /s/ John F. Norris Jr.  
John F. Norris Jr.  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 5, 2009

By: /s/ John P. Graham  
John P. Graham  
Chief Financial Officer  
(Principal Financial Officer)