FUEL TECH, INC.
Form 10-Q
May 09, 2011

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

(Mark One)

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

For the quarterly period ended March 31, 2011

or

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

For the transition period from __________ to __________

Commission file number: 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
www.ftek.com
(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 þ No o

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

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

On May 6, 2011 there were outstanding 24,223,467 shares of Common Stock, par value $0.01 per share, of the registrant.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31, 2011 (Unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 27,865	$ 30,524
Accounts receivable, net of allowance for doubtful accounts of $82 and $82, respectively	22,292	21,175
Inventories	993	807
Deferred income taxes		89
Prepaid expenses and other current assets	2,206	1,861
Total current assets	53,356	54,456
Property and equipment, net of accumulated depreciation of $16,547 and $15,767, respectively	14,380	14,384
Goodwill	21,051	21,051
Other intangible assets, net of accumulated amortization of $3,426 and $3,203, respectively	5,926	6,050
Deferred income taxes	4,796	5,000
Other assets	2,169	2,262
Total assets	$ 101,678	$ 103,203
Liabilities and Shareholders Equity		
Current liabilities:		
Short-term debt	$ 2,290	$ 2,269
Accounts payable	6,178	7,516
Accrued liabilities:		
Employee compensation	1,791	2,863
Income taxes payable	737	1,857
Other accrued liabilities	3,345	3,306
Total current liabilities	14,341	17,811
Other liabilities	1,509	1,482
Total liabilities	15,850	19,293
Shareholders equity:		
Common stock, $.01 par value, 40,000,000 shares authorized, 24,223,467 and 24,213,467 shares issued and outstanding	242	242

Additional paid-in capital		129,942		129,424
Accumulated deficit		(44,736)		(46,075)
Accumulated other comprehensive income		304		243
Nil coupon perpetual loan notes		76		76
Total shareholders equity		85,828		83,910
Total liabilities and shareholders equity	$	101,678	$	103,203

See notes to condensed consolidated financial statements.

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FUEL TECH, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in thousands, except share and per-share data)

	Three Months Ended March 31	
	2011	2010
Revenues	$ 22,622	$ 17,617
Costs and expenses:		
Cost of sales	11,466	9,500
Selling, general and administrative	7,951	7,480
Research and development	402	146
	19,819	17,126
Operating income	2,803	491
Interest expense	(40)	(44)
Interest income	1	1
Other expense	(40)	(92)
Income before income taxes	2,724	356
Income tax expense	(1,385)	(142)
Net income	$ 1,339	$ 214
Net income per common share:		
Basic	$ 0.06	$ 0.01
Diluted	$ 0.05	$ 0.01
Weighted-average number of common shares outstanding:		
Basic	24,214,000	24,212,000
Diluted	24,669,000	24,431,000

See notes to condensed consolidated financial statements.

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

	Three Months Ended March 31	
	2011	2010
Operating Activities		
Net income	$ 1,339	$ 214
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	760	939
Amortization	223	219
Loss on equipment disposals		6
Deferred income tax	120	(476)
Stock based compensation	617	1,352
Deferred director fees	20	
Changes in operating assets and liabilities:		
Accounts receivable	(938)	(2,041)
Inventories	(177)	(355)
Prepaid expenses, other current assets and other noncurrent assets	(239)	(116)
Accounts payable	(1,380)	(153)
Accrued liabilities and other noncurrent liabilities	(2,274)	1,096
Net cash (used in) provided by operating activities	(1,929)	685
Investing Activities		
Decrease in restricted cash		125
Purchases of property, equipment and patents	(841)	(307)
Net cash used in investing activities	(841)	(182)
Financing Activities		
Issuance of deferred shares		28
Proceeds from exercise of stock options	54	
Redemption of nil coupon loan note		(5)
Net cash provided by financing activities	54	23
Effect of exchange rate fluctuations on cash	57	(59)
Net (decrease) increase in cash and cash equivalents	(2,659)	467
Cash and cash equivalents at beginning of period	30,524	20,965
Cash and cash equivalents at end of period	$ 27,865	$ 21,432

See notes to condensed consolidated financial statements.

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FUEL TECH, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2011
(Unaudited)
(in thousands, except share and per-share data)

Note A: Nature of Business

Fuel Tech, Inc. (Fuel Tech or the Company or we , us , or our) 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. 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 as amended (Exchange Act), are made available through our website as soon as reasonably practical after electronically filed or furnished to the Securities and Exchange Commission. Also available on Fuel Tech 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 our 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® and HERT High Energy Reagent Technology SNCR systems; systems that incorporate ASCR(Advanced Selective Catalytic Reduction) technologies including CASCADE, ULTRA and NOxOUT-SCR® processes, Ammonia Injection Grid (AIG) and 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 ($PM_{2.5}$), carbon dioxide, NOx and unburned carbon in fly ash through the addition of chemicals into the fuel or via TIFI® 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 technology segments or are similar in their technological base. We have expended significant resources in the research and development of new technologies in building our proprietary portfolio of air pollution control, fuel and boiler treatment chemicals, computer modeling and advanced visualization technologies. 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 of the Exchange Act. 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, 2010 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, 2010 as filed with the Securities and Exchange Commission.

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.

Fuel Tech uses the percentage of completion method of accounting for equipment construction and license contracts that are sold within the Air Pollution Control technology segment. 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. Construction costs include all direct costs such as materials, labor, and subcontracting costs, and indirect costs allocable to the particular contract such as indirect labor, tools and equipment, supplies, and depreciation. Revisions in completion estimates and contract values are made in the period in which the facts giving rise to the revisions become known and can influence the timing of when revenues are recognized under the percentage of completion method of accounting. The completed contract method is used for certain contracts when reasonably dependable estimates of the percentage of completion cannot be made. When the completed contract method is used, revenue and costs are deferred until the contract is substantially complete, which usually occurs upon customer acceptance of the installed product. Provisions are made for estimated losses on uncompleted contracts in the period in which such losses are determined. As of March 31, 2011, the Company had no contracts in progress that were identified as loss contracts.

Fuel Tech s APC contracts are typically eight to sixteen months in length. A typical contract will have three or four critical operational measurements that, when achieved, serve as the basis for us to invoice the customer via progress billings. At a minimum, these measurements will include the generation of engineering drawings, the shipment of equipment and the completion of a system performance test.

As part of most of its contractual APC project agreements, Fuel Tech will agree to customer-specific acceptance criteria that relate to the operational performance of the system that is being sold. These criteria are determined based on mathematical modeling that is performed by Fuel Tech personnel, which is based on operational inputs that are provided by the customer. The customer will warrant that these operational inputs are accurate as they are specified in the binding contractual agreement. Further, the customer is solely responsible for the accuracy of the operating condition information; all performance guarantees and equipment warranties granted by us are void if the operating condition information is inaccurate or is not met.

Accounts receivable includes unbilled receivables, representing revenues recognized in excess of billings on uncompleted contracts under the percentage of completion method of accounting. At March 31, 2011 and December 31, 2010, unbilled receivables were approximately $10,398 and $6,800, respectively, and are included in accounts receivable on the consolidated balance sheets. Billings in excess of costs and estimated earnings on uncompleted contracts were $314 and $650, at March 31, 2011 and December 31, 2010, respectively. Such amounts are included in other accrued liabilities on the consolidated balance sheets.

Fuel Tech has installed over 640 units with APC technology and normally provides performance guarantees to our customers based on the operating conditions for the project. As part of the project implementation process, we perform system start-up and optimization services that effectively serve as a test of actual project performance. We believe that this test, combined with the accuracy of the modeling that is performed, enables revenue to be recognized prior to the receipt of formal customer acceptance.

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, restricted stock units (RSUs), and the nil coupon non-redeemable convertible unsecured loan notes. Diluted earnings per share includes the dilutive effect of stock options, restricted stock units, 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 month periods ended March 31, 2011 and 2011.

	Three Months Ended March 31:	
	2011	2010
Basic weighted-average shares	24,214,000	24,212,000
Conversion of unsecured loan notes	7,000	7,000
Unexercised options and RSUs	448,000	212,000
Diluted weighted-average shares	24,669,000	24,431,000

Note G: Total Comprehensive Income

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

	Three Months Ended March 31:	
	2011	2010
Comprehensive income:		
Net income	$ 1,339	$ 214
Foreign currency translation	61	(59)
	$ 1,400	$ 155

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, Restricted Stock Units (RSUs), 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. No options were granted in the three month periods ending March 31, 2011 and 2010. At March 31, 2011, Fuel Tech had approximately 448,000 and equity awards available for issuance under the Incentive Plan.

Stock-based compensation is included in selling, general, and administrative costs in our consolidated statements of operations. The components of stock-based compensation for the three month periods ended March 31, 2011 and 2010 were as follows:

	For the Three Months Ended March 31:	
	2011	**2010**

Stock options	$ 536	$ 1,352
Restricted stock units	81	
Total stock-based compensation expense	617	1,352
Tax benefit of stock-based compensation expense	(195)	(465)
After-tax effect of stock based compensation	$ 422	$ 887

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As of March 31, 2011, there was $4,818 of total unrecognized compensation cost related to all non-vested share-based compensation arrangements granted under the Incentive Plan.

Stock Options

The stock options granted to employees 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 for employee option awards based on the grant date fair value of the award, less expected annual forfeitures, and recognizes expense on a straight-line basis over the four-year service period of the award. Stock options granted to members of our board of directors vest immediately. Stock compensation for these awards is based on the grant date fair value of the award and is recognized in expense immediately.

Fuel Tech uses the Black-Scholes option pricing model to estimate the grant date fair value of employee stock options. 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.

Stock option activity for Fuel Tech s Incentive Plan for the three months ended March 31, 2011 was as follows:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding on January 1, 2011	2,856,125	$ 14.68		
Granted				
Exercised	(10,000)	5.40		
Expired or forfeited	(46,750)	22.62		
Outstanding on March 31, 2011	2,799,375	$ 14.58	5.6 years	$ 2,736
Exercisable on March 31, 2011	2,322,125	$ 14.93	5.2 years	$ 2,625

Non-vested stock option activity for the three months ended March 31, 2011 was as follows:

	Non-Vested Stock Options Outstanding	Weighted-Average Grant Date Fair Value
Outstanding on January 1, 2011	578,500	$ 7.50
Granted		
Vested	(89,500)	9.18
Forfeited	(11,750)	5.95
Outstanding on March 31, 2011	477,250	$ 7.23

As of March 31, 2011, there was $2,731 of total unrecognized compensation cost related to non-vested stock options granted under the Incentive Plan. That cost is expected to be recognized over a weighted average period of 1.5 years.

Fuel Tech received proceeds from the exercise of stock options of $54 in the three month period ended March 31, 2011. The intrinsic value of options exercised in the three month period ended March 31, 2011 was $34. It is our policy to issue new shares upon option exercises, loan conversions, and vesting of restricted stock units. We have not used cash and do not anticipate any future use of cash to settle equity instruments granted under share-based payment arrangements.

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Restricted Stock Units

Restricted stock units (RSUs) granted to employees vest over time based on continued service (typically vesting over a period between two and four years). Such time-vested RSUs are valued at the date of grant using the intrinsic value method. Compensation cost, adjusted for estimated forfeitures, is amortized on a straight-line basis over the requisite service period.

In addition to the time vested RSUs described above, in March 2011 the Company entered into a performance-based RSU agreement (the Agreement) with its executive management team. The Agreement includes three types of awards with each award type specifying a targeted number of RSUs that may be granted to each executive based on either the individual performance of the executive or the Company s relative performance compared to a peer group, as determined by the award type. The Compensation and Nominating Committee of our Board of Directors (the Committee) determines the extent to which, if any, RSUs will be granted based on the achievement of the applicable performance criteria specified in the Agreement. This determination will be made following the completion of the applicable performance period (each a Determination Date). Such performance based awards include the following:

The first type of award is based on individual performance during the 2011 calendar year as determined by the Committee based on performance criteria specified in the Agreement. These awards will vest over a three year period beginning on the Determination Date. We estimated the fair value of these performance-based RSU awards on the date of the Agreement using the intrinsic value method and our estimate of the probability that the specified performance criteria will be met. The fair value measurement and probability estimate will be re-measured each reporting date until the Determination Date, at which time the final award amount will be known. For these job performance-based awards, we amortize compensation costs over the requisite service period, adjusted for estimated forfeitures, for each separately vesting tranche of the award.

The second type of RSU award contains a targeted number of RSUs to be granted based on the Company s revenue growth relative to a specified peer group during the 2011 and 2012 calendar years. These awards vest 67% on the second anniversary of the Agreement date and 33% on the third anniversary of the Agreement date. We estimated the fair value of these performance-based RSU awards on the Agreement date using the intrinsic value method and our estimate of the probability that the specified performance criteria will be met. For these revenue growth performance-based awards, we amortize compensation costs over the requisite service period, adjusted for estimated forfeitures, for each separately vesting tranche of the award.

The third type of RSU award contains a targeted number of RSUs to be granted based on the total shareholder return (TSR) of the Company s common stock relative to a specified peer group during the 2011 and 2012 calendar years. These awards vest 67% on the second anniversary of the Agreement date and 33% on the third anniversary of the Agreement date. We estimated the fair value of these market-based RSU awards on the Agreement date using a Monte Carlo valuation methodology and amortize the fair value over the requisite service period for each separately vesting tranche of the award.

At March 31, 2011 there is $2,087 of unrecognized compensation costs related to restricted stock unit awards to be recognized over a weighted average period of 4 years.

A summary of restricted stock unit activity for the three month period ended March 31, 2011 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested restricted stock units at December 31, 2010	149,000	$ 8.63
Granted		
Forfeited		
Vested		
Unvested restricted stock units at March 31, 2011	149,000	$ 8.63

Deferred Directors Fees

In addition to the Incentive Plan, Fuel Tech has a Deferred Compensation Plan for Directors (Deferred Plan). Under the terms of the Deferred Plan, Directors can elect to defer Directors fees for shares of Fuel Tech Common Stock that are issuable at a future date as defined in the agreement. In accordance with ASC 718, Fuel Tech accounts for these awards as equity awards as

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opposed to liability awards. In the periods ended March 31, 2011 and 2010, Fuel Tech recorded $20 and $28, respectively, of stock-based compensation expense under the Deferred Plan.

At March 31, 2011, Fuel Tech had 1,924,000 weighted average stock awards outstanding that were not dilutive for the purpose of inclusion in the calculation of diluted earnings per share but could potentially become dilutive in future periods.

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 375 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 March 31, 2011 and December 31, 2010, 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.

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, a minimum tangible net worth of $42,000, adjusted upward for 50% of net income generated and 100% of all capital issuances, a minimum net income for the quarterly period ended June 30, 2009 of ($2,000), and minimum net income for the quarterly period ended September 30, 2009 of $750. There was not a minimum net income requirement for any periods subsequent to September 30, 2009. In addition, the original Facility covenants included a maximum Funded Debt to EBITDA Ratio (or Leverage Ratio , as defined in the Facility) of 2.0:1.0 based on the four trailing quarterly periods ended December 31, 2009 and a maximum Leverage Ratio of 1.5:1.0 based on the four trailing quarterly periods ending March 31, 2010 and 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. Due to the Company s quarterly net loss of ($698) for the three-month period ended September 30, 2009, however, the Company was in breach of its minimum quarterly net income covenant that was in effect at that time. The Company amended the Facility to obtain a waiver of this covenant breach from JPM Chase for the quarterly period ended September 30, 2009 and 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), for the three-month period ended March 31, 2010 the Company s Leverage Ratio shall not exceed 2.75:1.0, and for the three month period ended June 30, 2010 and each subsequent quarterly period, the Leverage Ratio shall not exceed 1.5:1.0. The purchase price for allowable acquisitions made during any fiscal year was also lowered to $5,000 in the aggregate if Leverage Ratio is greater than 2.75:1.0. The Company s spread matrix for rates and fees paid on its revolving credit facility and standby letters of credit was adjusted upward to include additional tiers tied to the quarterly calculated Leverage Ratio. No other Facility covenants were modified for any other period.

At March 31, 2011, the Company was in compliance with all financial covenants on the Facility, including a year-to-date capital expenditure amount of $841, a tangible net worth amount of $58,851, which was above the required amount of $53,762 by $5,090, and a Leverage Ratio of 0.33:1.0, which was well below the maximum requirement of 1.5:1.0.

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 45 million (approximately $6,900), which expires on June 30, 2011. The facility is unsecured, bears interest at a rate of 120% of the People s Bank of China (PBOC) Base Rate (approximately 6.4% and 5.8% at March 31, 2011 and December 31, 2010, respectively) and does not contain any material debt covenants. Beijing Fuel Tech can use this facility for cash advances and bank guarantees. As of March 31, 2011 and December 31, 2010, Beijing Fuel Tech has borrowings outstanding in the amount of $2,290 and $2,269, respectively.

At March 31, 2011 and December 31, 2010, the Company had outstanding standby letters of credit and bank guarantees, predominantly to customers, totaling approximately $1,045 and $1,265, respectively, in connection with contracts in process. Fuel Tech is committed to reimbursing the issuing bank for any payments made by the bank under these instruments. At March 31, 2011 and December 31, 2010, there were no cash borrowings under the revolving credit facility and approximately $23,955 and $23,735, respectively, was available for future borrowings. The Company pays a commitment fee of 0.25% per year on the unused portion of the revolving credit facility. Management has met with the Company s lending institutions and, during the course of those meetings, was not made aware of any information indicating that they will not be able to perform their obligations for any letters of credit or guarantees issued, nor be unable to supply funds to Fuel Tech if the Company chooses to borrow funds under its two revolving credit facilities.

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In the event of default on either the domestic facility or the China facility, the cross default feature in each allows the lending bank to accelerate the payments 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.

Interest payments in the amount of $40 and $44 were made during the three month periods ended March 31, 2011 and 2010, respectively.

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 includes technologies to reduce NOx emissions in flue gas from boilers, incinerators, furnaces and other stationary combustion sources. These include Low and Ultra Low NOx Burners (LNB and ULNB), Over-Fire Air (OFA) systems, NOxOUT® and HERT Selective Non-Catalytic Reduction (SNCR) systems, and Advanced Selective Catalytic Reduction (ASCR™) systems. The ASCR system includes ULNB, OFA, and SNCR components, along with a downsized SCR catalyst, Ammonia Injection Grid (AIG), and Graduated Straightening Grid (GSG) systems to provide high NOx reductions at significantly lower capital and operating costs than conventional SCR systems. The CASCADE and NOxOUT-SCR® processes are basic types of ASCR systems, using just SNCR and SCR catalyst components. ULTRA technology creates ammonia at a plant site using safe urea for use with any SCR application. Flue Gas Conditioning systems are chemical injection systems offered in markets outside the U.S. and Canada to enhance electrostatic precipitator and fabric filter performance in controlling particulate emissions.
- The FUEL CHEM® technology segment, which uses chemical processes in combination with advanced Computational Fluid Dynamics (CFD) and Chemical Kinetics Modeling (CKM) boiler modeling, for the control of slagging, fouling, corrosion, opacity and other sulfur trioxide-related issues in furnaces and boilers through the addition of chemicals into the furnace using TIFI® Targeted In-Furnace Injection technology.

The Other classification includes those profit and loss items not allocated by Fuel Tech to each reportable segment. Further, there are no intersegment sales that require elimination.

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 (Note 1 in our annual report on Form 10-K). Fuel Tech does not review assets by reportable segment, but rather, in aggregate for Fuel Tech as a whole.

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Information about reporting segment net sales and gross margin are provided below:

Three months ended March 31, 2011	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Revenues from external customers	$11,092	$11,530	$	$ 22,622
Cost of sales	(5,553)	(5,913)		(11,466)
Gross margin	5,539	5,617		11,156
Selling, general and administrative			(7,951)	(7,951)
Research and development			(402)	(402)
Operating income	$ 5,539	$ 5,617	$(8,353)	$ 2,803

Three months ended March 31, 2010	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Revenues from external customers	$ 8,214	$ 9,403	$	$17,617
Cost of sales	(5,258)	(4,242)		(9,500)
Gross margin	2,956	5,161		8,117
Selling, general and administrative			(7,480)	(7,480)
Research and development			(146)	(146)
Operating income	$ 2,956	$ 5,161	$(7,626)	$ 491

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 March 31: 2011	2010
Revenues:		
United States	$ 19,618	$ 15,041
Foreign	3,004	2,576
	$ 22,622	$ 17,617

	March 31, 2011	December 31, 2010
Assets:		

United States	$ 90,818	$ 92,485
Foreign	10,860	10,718
	$ 101,678	$ 103,203

Note K: Contingencies

Fuel Tech issues a standard product warranty with the sale of its products to customers. Our 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 provides an aggregate warranty accrual that is historically aligned with actual warranty claims experienced.

Changes in the warranty liability for the three months ended March 31, 2011 and 2010 are summarized below:

	Three Months Ended March 31:	
	2011	2010
Aggregate product warranty liability at beginning of period	$ 215	$ 199
Net aggregate expense related to product warranties	30	30
Aggregate reductions for payments	(33)	(35)
Aggregate product warranty liability at end of period	$ 212	$ 194

Note L: Income Taxes

The Company s effective tax rates of 50.8% and 39.8% for the three month periods ended March 31, 2011 and 2010, respectively, differ from the statutory federal tax rate due primarily to state taxes, stock based compensation, differences between U.S. and foreign tax rates, foreign losses incurred with no related tax benefit, and non-deductible meals and entertainment expenses.

Fuel Tech had unrecognized tax benefits as of December 31, 2010 in the amount of $870 all of 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 three months ended March 31, 2011.

Note M: Goodwill and Other Intangibles

Goodwill and indefinite-lived intangible assets are not amortized, but are reviewed annually or more frequently if indicators arise, for impairment. The evaluation of impairment involves comparing the current fair value of our reporting units to their carrying values. Fuel Tech uses a discounted cash flow (DCF) model to determine the current fair value of its two reporting units. A number of significant assumptions and estimates are involved in the application of the DCF model to forecast operating cash flows, including markets and market share, sales volumes and prices, costs to produce and working capital changes. Management considers historical experience and all available information at the time the fair values of its reporting units are estimated. However, actual fair values that could be realized in an actual transaction may differ from those used to evaluate the impairment of 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 technology segment and the APC technology segment. At March 31, 2011 and December 31, 2010, goodwill allocated to the FUEL CHEM technology segment was $1,723 while goodwill allocated to the APC technology segment was $19,328.

Goodwill is allocated to each of our reporting units after considering the nature of the net assets giving rise to the goodwill and how each reporting unit would enjoy the benefits and synergies of the net assets acquired. Our last fair value measurement test, performed annually as of October 1, revealed no indications of impairment. There were no indications of goodwill impairment in the three month period ended March 31, 2011.

Fuel Tech reviews other intangible assets, which include customer lists and relationships, covenants not to compete, patent assets, tradenames, and acquired technologies, for impairment on a recurring basis or when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. In the event that impairment indicators exist, a further analysis is performed and if the sum of the expected undiscounted future cash flows resulting from the use of the asset is less than the carrying amount of the asset, an impairment loss equal to the excess of the asset s carrying value over its fair value is recorded. Management considers historical experience and all available information at the time the estimates of future cash flows are made, however, the actual cash values that could be realized may differ from those that are estimated. There were no indications of intangible asset impairment in the three month period ended March 31, 2011.

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 March 31, 2011 and 2010 were $22,622 and $17,617, respectively. The 28% increase versus the prior year is due to both the Air Pollution Control and FUEL CHEM technology segment.

The Air Pollution Control (APC) technology segment generated revenues of $11,092 for the three months ended March 31, 2011, an increase of $2,878, or 35%, from the prior year due to the timing of recognition of prior period bookings and work progress on construction projects. This segment remains uniquely positioned to capitalize on the next phase of increasingly stringent U.S. 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. The Company expects demand for its APC products to remain strong throughout the remainder of 2011.

Consolidated APC backlog at March 31, 2011 was $14,500 versus backlog at March 31, 2010 of approximately $21,000. Substantially all of the backlog as of March 31, 2011 should be recognized as revenue in fiscal 2011, although the timing of such revenue recognition in 2011 is subject to the timing of the expenses incurred on existing projects.

The FUEL CHEM technology segment generated revenues of $11,530 for the three months ended March 31, 2011, an increase of $2,127, or 23%, versus the prior year. This increase is primarily attributed to the addition of new accounts. We believe the marketplace acceptance for Fuel Tech s patented TIFI® Targeted In-Furnace Injection technology remains strong, particularly on coal-fired units, which represents the largest market opportunity for the technology.

Cost of sales as a percentage of revenue for the quarters ended March 31, 2011 and 2010 was 51% and 54%, respectively. The cost of sales percentage for the APC technology segment decreased to 50% from 64% in the comparable prior-year period, primarily due to an increase in higher margin project mix. For the FUEL CHEM technology segment, the cost of sales percentage increased to 51% from 45% in the comparable prior-year quarter primarily due to the recognition in the first quarter of 2010 of $2,000 in contingent risk share revenue from a successful demonstration program for which the associated costs were recognized in prior periods.

Selling, general and administrative expenses (SG&A) for the quarters ended March 31, 2011 and 2010 were $7,951 and $7,480, respectively. Of the $471 increase in SG&A for the quarter versus the prior year, $860 is due to employee related expenses including incentive compensation, and $470 is due to an increase in fees to outside service providers. Partially offsetting these amounts was $120 in depreciation expense and a decrease of $750 in stock compensation expense due to the vesting of options granted in earlier periods with a comparatively higher grant date fair value than more recent grants.

Research and development expenses for the quarters ended March 31, 2011 and 2010 were $402 and $146, respectively. The Company has increased its R&D efforts 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 expense for the three month periods ended March 31, 2011 and 2010 totaled $40 and $44, respectively, and relates to borrowings for the Beijing Fuel Tech Facility.

Income tax expense for the quarters ended March 31, 2011 and 2010 was $1,385 and $142, respectively, and reflective of the Company s net income for the respective quarters. The Company is projecting a consolidated effective tax rate of 51% for 2011.

Liquidity and Sources of Capital

At March 31, 2011, Fuel Tech had cash and cash equivalents and short-term investments on hand of $27,865 and working capital of $39,015 versus $30,524 and $36,645 at December 31, 2010, respectively.

Operating activities used cash of $1,929 during the three-month period ended March 31, 2011, primarily due to payments made during the quarter related to the following: insurance and other assets of $239; accounts payable, accrued liabilities, and income taxes of $3,654; inventory purchases of $177; and a decrease in our accounts receivable balance of $938. Partially offsetting these items was cash generated by our net income of $1,339 plus other non-cash items such as stock-based compensation of $617, depreciation and amortization of $983, and deferred income taxes of $120.

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Investing activities used cash of $841 during the three month period ended March 31, 2011 due to purchases of property, equipment, and patent expenditures.

Financing activities generated cash of $54 related to proceeds received from the exercise of stock options during the period.

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 375 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 March 31, 2011 and December 31, 2010, 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.

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, a minimum tangible net worth of $42,000, adjusted upward for 50% of net income generated and 100% of all capital issuances, a minimum net income for the quarterly period ended June 30, 2009 of ($2,000), and minimum net income for the quarterly period ended September 30, 2009 of $750. There was not a minimum net income requirement for any periods subsequent to September 30, 2009. In addition, the original Facility covenants included a maximum Funded Debt to EBITDA Ratio (or Leverage Ratio , as defined in the Facility) of 2.0:1.0 based on the four trailing quarterly periods ended December 31, 2009 and a maximum Leverage Ratio of 1.5:1.0 based on the four trailing quarterly periods ending March 31, 2010 and 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. Due to the Company s quarterly net loss of ($698) for the three-month period ended September 30, 2009, however, the Company was in breach of its minimum quarterly net income covenant that was in effect at that time. The Company amended the Facility to obtain a waiver of this covenant breach from JPM Chase for the quarterly period ended September 30, 2009 and 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), for the three-month period ended March 31, 2010 the Company s Leverage Ratio shall not exceed 2.75:1.0, and for the three month period ended June 30, 2010 and each subsequent quarterly period, the Leverage Ratio shall not exceed 1.5:1.0. The purchase price for allowable acquisitions made during any fiscal year was also lowered to $5,000 in the aggregate if Leverage Ratio is greater than 2.75:1.0. The Company s spread matrix for rates and fees paid on its revolving credit facility and standby letters of credit was adjusted upward to include additional tiers tied to the quarterly calculated Leverage Ratio. No other Facility covenants were modified for any other period.

At March 31, 2011, the Company was in compliance with all financial covenants on the Facility, including a year-to-date capital expenditure amount of $841, a tangible net worth amount of $58,851, which was above the required amount of $53,762 by $5,090, and a Leverage Ratio of 0.33:1.0, which was well below the maximum requirement of 1.5:1.0.

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 45 million (approximately $6,900), which expires on June 30, 2011. The facility is unsecured, bears interest at a rate of 120% of the People s Bank of China (PBOC) Base Rate (approximately 6.4% and 5.8% at March 31, 2011 and December 31, 2010, respectively) and does not contain any material debt covenants. Beijing Fuel Tech can use this facility for cash advances and bank guarantees. As of March 31, 2011 and December 31, 2010, Beijing Fuel Tech has borrowings outstanding in the amount of $2,290 and $2,269, respectively.

At March 31, 2011 and December 31, 2010, the Company had outstanding standby letters of credit and bank guarantees, predominantly to customers, totaling approximately $1,045 and $1,265, respectively, in connection with contracts in process. Fuel Tech is committed to reimbursing the issuing bank for any payments made by the bank under these instruments. At March 31, 2011 and December 31, 2010, there were no cash borrowings under the revolving credit facility and approximately $23,955 and $23,735, respectively, was available. The Company pays a commitment fee of 0.25% per year on the unused portion of the revolving credit facility. Management has met with the Company s lending institutions and, during the course of those meetings, was not made aware of any information indicating that they will not be able to perform their obligations for any letters of credit or guarantees issued, nor be unable to supply funds to Fuel Tech if the Company chooses to borrow funds under its two revolving credit facilities. In the event of default on either the JPM Chase domestic facility or the JPM Chase China facility, the cross default feature in each allows the lending bank to accelerate the payments 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.

In the opinion of management, Fuel Tech s expected near-term revenue growth will be driven by the timing of penetration of the utility marketplace via utilization of its TIFI technology, by utility and industrial entities adherence to the NOx reduction requirements of the various domestic environmental regulations, and by the expansion of both business segments in non-U.S. geographies. Fuel Tech expects its liquidity requirements to be met by the operating results generated from these activities.

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 March 31, 2011 was not significant.

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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 th 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, 2010 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.

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, 2011.

Item 4. Controls and Procedures

Evaluation of Disclosure 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 Exchange Act 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 Chief Executive Officer and Chief Financial Officer have evaluated the Company s disclosure controls and procedures, as defined in Rules 13a 15(e) and 15d -15(e) of the Exchange Act,, as of the end of the period covered by this report, and they have concluded that these controls and procedures are effective.

Changes in Internal Control over Financial Reporting

There has been no change in the Company s internal control over financial reporting during the quarter covered by this report that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 1A. Risk Factors

The risk factors included in our Annual Report on Form 10-K for fiscal year ended December 31, 2010 have not materially changed.

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

None

Item 6. Exhibits

a. Exhibits (all filed herewith)

4.1	Fuel Tech, Inc. Form of 2011 Executive Performance RSU Award Agreement
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

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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: May 9, 2011	By: /s/ Douglas G. Bailey Douglas G. Bailey President and Chief Executive Officer (Principal Executive Officer)
Date: May 9, 2011	By: /s/ David S. Collins David S. Collins Senior Vice President and Chief Financial Officer (Principal Financial Officer)