

FUELCELL ENERGY INC

Form 10-Q

March 14, 2011

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

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

**For the quarterly period ended January 31, 2011
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: 1-14204
FUELCELL ENERGY, INC.**

(Exact name of registrant as specified in its charter)

Delaware

06-0853042

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

**3 Great Pasture Road
Danbury, Connecticut**

06813

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: **(203) 825-6000**

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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

Number of shares of common stock, par value \$.0001 per share, outstanding at March 11, 2011: 124,235,713

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FUELCELL ENERGY, INC.
Consolidated Balance Sheets
(Unaudited)

(Amounts in thousands, except share and per share amounts)

	January 31, 2011	October 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 26,085	\$ 20,467
Investments U.S. treasury securities	39,537	25,019
Accounts receivable, net	23,288	18,066
Inventories, net	32,352	33,404
Other current assets	6,343	5,253
Total current assets	127,605	102,209
Property, plant and equipment, net	25,391	26,679
Investments U.S. treasury securities	4,529	9,071
Investment in and loans to affiliate	9,653	9,837
Other assets, net	3,494	2,733
Total assets	\$ 170,672	\$ 150,529
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of long-term debt and other liabilities	\$ 1,998	\$ 976
Accounts payable	10,065	10,267
Accounts payable due to affiliate	407	575
Accrued liabilities	15,819	16,721
Deferred revenue	37,902	25,499
Total current liabilities	66,191	54,038
Long-term deferred revenue	7,750	8,042
Long-term debt and other liabilities	4,112	4,056
Total liabilities	78,053	66,136
Redeemable preferred stock of subsidiary	17,374	16,849
Redeemable preferred stock (liquidation preference of \$64,020 at January 31, 2011 and October 31, 2010)	59,857	59,857
Total Equity:		
Shareholders' equity		
Common stock (\$.0001 par value); 150,000,000 shares authorized; 123,633,555 and 112,965,725 shares issued and outstanding at January 31, 2011 and	12	11

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October 31, 2010, respectively.

Additional paid-in capital	682,656	663,951
Accumulated deficit	(666,561)	(655,623)
Accumulated other comprehensive income	13	11
Treasury stock, Common, at cost (5,679 shares at January 31, 2011 and October 31, 2010)	(53)	(53)
Deferred compensation	53	53
Total shareholders' equity	16,120	8,350
Noncontrolling interest in subsidiaries	(732)	(663)
Total equity	15,388	7,687
Total liabilities and equity	\$ 170,672	\$ 150,529

See accompanying notes to consolidated financial statements.

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FUELCELL ENERGY, INC.
Consolidated Statements of Operations
(Unaudited)

(Amounts in thousands, except share and per share amounts)

	Three Months Ended	
	January 31,	
	2011	2010
Revenues:		
Product sales and revenues	\$ 25,760	\$ 12,808
Research and development contracts	2,320	1,808
Total revenues	28,080	14,616
Costs and expenses:		
Cost of product sales and revenues	28,059	18,013
Cost of research and development contracts	2,337	2,096
Administrative and selling expenses	4,050	4,156
Research and development expenses	4,246	4,620
Total costs and expenses	38,692	28,885
Loss from operations	(10,612)	(14,269)
Interest expense	(54)	(63)
Loss from equity investment	(198)	(148)
Interest and other income, net	400	319
Loss before redeemable preferred stock of subsidiary	(10,464)	(14,161)
Accretion of redeemable preferred stock of subsidiary	(525)	(557)
Loss before provision for income taxes	(10,989)	(14,718)
Provision for income taxes	(18)	
Net loss	(11,007)	(14,718)
Net loss attributable to noncontrolling interest	69	86
Net loss attributable to FuelCell Energy, Inc.	(10,938)	(14,632)
Preferred stock dividends	(800)	(802)

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Net loss to common shareholders	\$ (11,738)	\$ (15,434)
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Loss per share basic and diluted:

Net loss per share to common shareholders	\$ (0.10)	\$ (0.18)
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Basic and diluted weighted average shares outstanding	115,086,014	84,401,558
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See accompanying notes to consolidated financial statements.

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FUELCELL ENERGY, INC.
Consolidated Statements of Cash Flows
(Unaudited)
(Amounts in thousands)

	Three Months Ended	
	January 31,	
	2011	2010
Cash flows from operating activities:		
Net loss	\$ (11,007)	\$ (14,718)
Adjustments to reconcile net loss to net cash used in operating activities:		
Share-based compensation	780	642
Loss from equity investment	198	148
Accretion of redeemable preferred stock of subsidiary	525	557
Interest receivable on loan to affiliate	(43)	(34)
Loss on derivatives	28	8
Depreciation	1,634	1,923
Amortization of bond premium	20	13
Provision for doubtful accounts	26	12
(Increase) decrease in operating assets:		
Accounts receivable	(5,248)	(1,105)
Inventories	1,052	(5,989)
Other assets	(1,610)	2,543
Increase (decrease) in operating liabilities:		
Accounts payable	(370)	(2,095)
Accrued liabilities	(249)	1,742
Deferred revenue	12,111	10,707
Net cash used in operating activities	(2,153)	(5,646)
Cash flows from investing activities:		
Capital expenditures	(251)	(660)
Treasury notes matured	12,000	5,000
Treasury notes purchased	(21,996)	(10,074)
Net cash used in investing activities	(10,247)	(5,734)
Cash flows from financing activities:		
Repayment of debt	(64)	(106)
Proceeds from revolving line of credit	1,000	
Payment of preferred dividends	(800)	(802)
Proceeds from sale of common stock, net of registration fees	17,880	
Net cash provided by (used in) financing activities	18,016	(908)
Effects on cash from changes in foreign currency rates	2	8

Net increase (decrease) in cash and cash equivalents	5,618	(12,280)
Cash and cash equivalents-beginning of period	20,467	57,823
Cash and cash equivalents-end of period	\$ 26,085	\$ 45,543
Supplemental cash flow disclosures:		
Cash interest paid	\$ 54	\$ 63
Noncash financing and investing activity:		
Common stock issued in settlement of prior year bonus obligation	\$ 707	\$
Common stock issued for Employee Stock Purchase Plan in settlement of prior year accrued employee contributions	\$ 58	\$ 109
Accrued sale of common stock, cash received in subsequent period	\$ 193	\$
Accrued fees related to sale of common stock	\$ 112	\$

See accompanying notes to consolidated financial statements.

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FUELCELL ENERGY, INC.

Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts in thousands, except share and per share amounts)

Note 1. Nature of Business and Basis of Presentation

FuelCell Energy, Inc. and subsidiaries (the Company, we, us, or our) is a Delaware corporation engaged in development and manufacture of high temperature fuel cells for clean electric power generation. Our Direct FuelCell power plants produce reliable, secure and environmentally friendly 24/7 base load electricity for commercial, industrial, government and utility customers. We have commercialized our stationary fuel cells and are beginning the development of planar solid oxide fuel cell and other fuel cell technology. We expect to incur losses as we continue to participate in government cost share programs, sell certain products at prices lower than current production costs, and invest in cost reduction initiatives.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial information. Accordingly, they do not contain all of the information and footnotes required by accounting principles generally accepted in the United States of America (GAAP) for complete financial statements. In the opinion of management, all normal and recurring adjustments necessary to fairly present our financial position as of January 31, 2011 have been included. All intercompany accounts and transactions have been eliminated.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The balance sheet at October 31, 2010 has been derived from the audited financial statements at that date, but it does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with our financial statements and notes thereto for the year ended October 31, 2010, which are contained in our Annual Report on Form 10-K previously filed with the Securities and Exchange Commission. The results of operations for the interim periods presented are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year.

Use of Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Estimates are used in accounting for, among other things, revenue recognition, excess, slow-moving and obsolete inventories, product warranty costs, reserves on long-term service agreements, allowance for uncollectible receivables, depreciation and amortization, impairment of assets, taxes, and contingencies. Estimates and assumptions are reviewed periodically, and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary. Due to the inherent uncertainty involved in making estimates, actual results in future periods may differ from those estimates.

Concentrations

We contract with a small number of customers for the sale of products and for research and development contracts. For the three months ended January 31, 2011 and 2010 respectively, our top three customers, POSCO Power (POSCO), the U.S. government (primarily the Department of Energy) and Pacific Gas & Electric in the aggregate accounted for 83 percent and 75 percent of our consolidated revenues. Our largest strategic partner, POSCO, accounted for 62 percent and 63 percent of total revenues, the U.S. government accounted for 8 percent and 12 percent of total revenues, and Pacific Gas & Electric accounted for 13 percent and 0 percent of total revenues for the three months ended January 31, 2011 and 2010, respectively.

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Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts in thousands, except share and per share amounts)

Subsequent Events

We have evaluated subsequent events and transactions for potential recognition or disclosure in the financial statements. See Note 12.

Comprehensive Loss

Comprehensive loss for the periods presented was as follows:

	Three Months Ended	
	January 31,	
	2011	2010
Net loss	\$ (11,007)	\$ (14,718)
Foreign currency translation adjustments	2	8
Comprehensive loss	\$ (11,005)	\$ (14,710)

Note 2. Recent Accounting Pronouncements***Recently Adopted Accounting Guidance***

In April 2010, the FASB provided guidance on defining a milestone and determining when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Research or development arrangements frequently include payment provisions whereby a portion or all of the consideration is contingent upon the achievement of milestone events. An entity may only recognize consideration that is contingent upon the achievement of a milestone in its entirety in the period the milestone is achieved only if the milestone meets certain criteria. We adopted this guidance effective November 1, 2010 and it did not impact our financial statements.

In December 2009, the FASB issued revised guidance related to the consolidation of variable interest entities (VIE). The revised guidance requires reporting entities to evaluate former qualified special purpose entities for consolidation, changes the approach to determining a VIE s primary beneficiary from a quantitative assessment to a qualitative assessment designed to identify a controlling financial interest, and increases the frequency of required reassessments to determine whether a company is the primary beneficiary of a VIE. It also clarifies, but does not significantly change, the characteristics that identify a VIE. We adopted this guidance effective November 1, 2010 and it did not impact our financial statements.

In October 2009, the FASB issued guidance updating accounting standards for revenue recognition for multiple-deliverable arrangements. The stated objective of the update was to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services separately rather than as a combined unit. The guidance provides amended methodologies for separating consideration in multiple-deliverable arrangements and expands disclosure requirements. We adopted this guidance for revenue arrangements entered into or materially modified after November 1, 2010 and it did not have an impact on our financial statements or disclosures.

In June 2009, the FASB issued accounting guidance which requires a company to perform ongoing reassessment of whether it is the primary beneficiary of a variable interest entity (VIE). Specifically, the guidance modifies how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The guidance clarifies that the determination of whether a company is required to consolidate a VIE is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the VIE that most significantly impact the VIE s economic performance. The guidance requires an ongoing reassessment of whether a company is the primary beneficiary of a VIE and enhanced disclosures of the company s involvement in VIEs and any significant changes in risk exposure due to that involvement. We adopted this guidance effective November 1, 2010 and it did not have an impact on our financial statements.

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FUELCELL ENERGY, INC.

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(Tabular amounts in thousands, except share and per share amounts)

Recent Accounting Guidance Not Yet Effective

In January 2010, the FASB issued guidance that requires new disclosures for fair value measurements and provides clarification for existing disclosure requirements. This amended guidance require disclosures about inputs and valuation techniques used to measure fair value as well as disclosures about significant transfers in and out of Levels 1 and Levels 2 fair value measurements and disclosures about the purchase, sale, issuance and settlement activity of Level 3 fair value measurements. This guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for disclosures about the purchase, sale, issuance and settlement activity of Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010. The Company was not impacted by the disclosures effective for interim periods beginning after December 15, 2009 and we do not expect the remaining disclosures required after December 15, 2010 upon adoption of this guidance will have a material impact on our financial statements or disclosures

Note 3. Equity investments

Versa Power Systems, Inc. (Versa) is one of our sub-contractors under the Department of Energy s (DOE) large-scale hybrid project to develop a coal-based, multi-megawatt solid oxide fuel cell (SOFC) based hybrid system. Versa is a private company founded in 2001 that is developing advanced SOFC systems for various stationary and mobile applications. We have a 39 percent ownership interest and account for Versa under the equity method of accounting. We recognize our share of the losses as loss from equity investments on the consolidated statements of operations.

In 2007, we loaned Versa \$2.0 million in the form of a convertible note (the 2007 Convertible Note). In 2009 and 2010, we loaned Versa \$0.6 million in each year in the form of convertible notes (the 2009 Convertible Note and the 2010 Convertible Note , respectively). The 2007 Convertible Note matures May 2017, the 2009 Convertible Note matures November 2018 and the 2010 Convertible Note matures April 2020, unless certain prepayment events occur. In conjunction with the Convertible Notes, we received warrants for the right to purchase 3,969 shares of Versa common stock at a weighted average exercise price of \$165 per share. Our ownership percentage would increase to 45 percent if the Convertible Notes and warrants are converted into common stock.

We have determined that the above warrants represent derivatives subject to fair value accounting. The fair value is determined based on the Black-Scholes valuation model using historical stock price, volatility (based on a peer group since Versa s common stock is not publicly traded) and risk-free interest rate assumptions. The fair value of the warrants is included within investment and loan to affiliate on the consolidated balance sheets and changes in the fair value of the warrants are included in interest and other income on the consolidated statements of operations. The fair value of the warrants as of January 31, 2011 and October 31, 2010 was \$0.2 million. The change in the fair value of the warrants was not material to the consolidated financial statements for the three months ended January 31, 2011 and 2010. The carrying value of our investment in and loans to Versa was \$9.7 million and \$9.8 million as of January 31, 2011 and October 31, 2010, respectively.

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Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts in thousands, except share and per share amounts)

Note 4. Investments in U.S. Treasury Securities

We classify our investments as held-to-maturity and record them at amortized cost. These investments consist entirely of U.S. treasury securities. The following table summarizes the amortized cost basis and fair value (based on quoted market prices) at January 31, 2011 and October 31, 2010:

	Amortized cost	Gross unrealized gains	Gross unrealized (losses)	Fair value
<i>U.S. government obligations</i>				
As of January 31, 2011	\$ 44,066	\$ 51	\$	\$ 44,117
As of October 31, 2010	\$ 34,090	\$ 74	\$	\$ 34,164

The following table summarizes the contractual maturities of investments at amortized cost and fair value as of January 31, 2011:

	Amortized cost	Fair value	Weighted average yield to maturity
Due within one year	\$ 39,537	\$ 39,566	0.4%
Due after one year	4,529	4,551	1.4%
Total investments	\$ 44,066	\$ 44,117	0.5%

Note 5. Inventories

The components of inventory at January 31, 2011 and October 31, 2010 consisted of the following:

	January 31, 2011	October 31, 2010
Raw materials	\$ 15,648	\$ 15,509
Work-in-process	19,754	22,786
Gross Inventory	\$ 35,402	\$ 38,295
Less amount to reduce certain inventories to lower of cost or market	(3,050)	(4,891)
Net inventory	\$ 32,352	\$ 33,404

Raw materials consist mainly of various nickel powders and steels, various other components used in producing cell stacks and purchased components for balance of plant. Work-in-process inventory is comprised of material, labor, and overhead costs incurred to build fuel cell stacks, which are subcomponents of a power plant. Work in process also includes costs related to power plants in inventory which have not yet been dedicated to a particular commercial customer contract. The above inventory amounts include a lower of cost or market adjustment to write down the carrying value of inventory to its estimated market value.

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FUELCELL ENERGY, INC.
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(Unaudited)

(Tabular amounts in thousands, except share and per share amounts)

Note 6. Accounts Receivable

Accounts receivable at January 31, 2011 and October 31, 2010 consisted of the following:

	January 31, 2011	October 31, 2010
U.S. Government:		
Amount billed	\$ 374	\$ 223
Unbilled recoverable costs	640	605
	1,014	828
Commercial Customers:		
Amount billed	10,714	9,718
Unbilled recoverable costs	11,560	7,520
	22,274	17,238
	\$ 23,288	\$ 18,066

We bill customers for power plant and module sales based on certain milestones being reached. We bill the U.S. government for research and development contracts based on actual recoverable costs incurred, typically in the month subsequent to incurring costs. Unbilled recoverable costs relate to revenue recognized on customer contracts that have not been billed. Accounts receivable are presented net of an allowance for doubtful accounts of \$0.4 million at January 31, 2011 and October 31, 2010.

Note 7. Revolving Credit Facility

In January 2011, the Company entered into a \$5.0 million revolving credit facility with JPMorgan Chase Bank, N.A. and the Export-Import Bank of the United States. The credit facility is to be used for working capital to finance the manufacture and production and subsequent export sale of the Company's products or services. The agreement has a one year term with renewal provisions. The outstanding principal balance of the facility will bear interest, at the option of the Company of either the one-month LIBOR plus 1.5 percent or the prime rate of JP Morgan Chase. The facility is secured by certain working capital assets and general intangibles, up to the amount of the outstanding facility balance. Aside from certain negative covenants limiting the Company's ability to merge or acquire another company, sell non-inventory assets, create liens against collateral or change the organizational structure or identity, the facility does not require compliance with any financial covenants. At January 31, 2011, the outstanding amount owed under this facility was \$1.0 million and is classified as current portion of long-term debt and other liabilities on the Consolidated Balance Sheet.

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Notes to Consolidated Financial Statements

(Unaudited)

(Tabular amounts in thousands, except share and per share amounts)

Note 8. Share-Based Compensation Plans

We have shareholder approved equity incentive plans and a shareholder approved Section 423 Stock Purchase Plan (the ESPP). We account for stock awards to employees and non-employee directors under the fair value method. We determine the fair value of stock options at the grant date using the Black-Scholes valuation model. The model requires us to make estimates and assumptions regarding the expected life of the award, the risk-free interest rate, the expected volatility of our common stock price and the expected dividend yield. The fair value of restricted stock awards (RSA) is based on the common stock price on the date of grant. The fair value of stock awards is amortized to expense over the vesting period, generally four years.

Share-based compensation reflected in the consolidated statements of operations for the three months ended January 31, 2011 and 2010 was as follows:

	Three months ended	
	January 31,	
	2011	2010
Cost of product sales and revenues	\$ 143	\$ 224
Cost of research and development contracts	19	39
General and administrative expense	406	194
Research and development expense	212	185
Total share-based compensation	\$ 780	\$ 642

The following table summarizes stock option activity for the three months ended January 31, 2011:

	Number of	Weighted
	options	average
		option price (\$)
Outstanding at October 31, 2010	5,118,201	10.15
Cancelled	(178,325)	25.27
Outstanding at January 31, 2011	4,939,876	9.61

As of January 31, 2011, there were 1,190,111 RSAs outstanding with a weighted average per share fair value of \$2.73. There were 4,000 RSAs granted during the three months ended January 31, 2011 and forfeitures totaled 12,423 during this period.

For the three months ended January 31, 2011, 60,082 shares were issued under the ESPP at a per share cost of \$0.97. There were 67,621 shares of common stock reserved for issuance under the ESPP as of January 31, 2011.

Note 9. Share