

FUELCELL ENERGY INC

Form 10-Q

June 09, 2010

**Table of Contents**

**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 April 30, 2010  
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   
(Do not check if a smaller reporting company)

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 June 7, 2010: 85,307,401



**FUELCELL ENERGY, INC.**  
**FORM 10-Q**  
**Table of Contents**

	<b>Page</b>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Consolidated Financial Statements (unaudited)	
<u>Consolidated Balance Sheets as of April 30, 2010 and October 31, 2009</u>	3
<u>Consolidated Statements of Operations for the three months ended April 30, 2010 and 2009</u>	4
<u>Consolidated Statements of Operations for the six months ended April 30, 2010 and 2009</u>	5
<u>Consolidated Statements of Cash Flows for the six months ended April 30, 2010 and 2009</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	37
<u>Item 4. Controls and Procedures</u>	38
<b><u>PART II. OTHER INFORMATION</u></b>	
<u>Item 1. Legal Proceedings</u>	39
<u>Item 1A. Risk Factors</u>	39
<u>Item 6. Exhibits</u>	39
<u>Signature</u>	40
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32.1</u>	
<u>Exhibit 32.2</u>	

**Table of Contents**

**FUELCELL ENERGY, INC.**  
**Consolidated Balance Sheets**  
**(Unaudited)**

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

	<b>April 30, 2010</b>	<b>October 31, 2009</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 24,112	\$ 57,823
Investments U.S. treasury securities	3,012	7,004
Accounts receivable, net	18,110	22,920
Inventories, net	30,284	25,433
Other current assets	4,620	6,499
Total current assets	80,138	119,679
Property, plant and equipment, net	30,314	32,394
Investments U.S. treasury securities	16,630	
Investment in and loans to affiliate	10,260	10,064
Other assets, net	600	551
Total assets	\$ 137,942	\$ 162,688
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Current portion of long-term debt and other liabilities	\$ 984	\$ 997
Accounts payable	6,271	8,484
Accounts payable due to affiliate	305	1,584
Accrued liabilities	15,027	13,808
Deferred revenue, royalty income and customer deposits	25,331	17,013
Total current liabilities	47,918	41,886
Long-term deferred revenue and royalty income	8,943	10,124
Long-term debt and other liabilities	4,245	4,410
Total liabilities	61,106	56,420
Redeemable preferred stock of subsidiary	15,823	14,976
Redeemable preferred stock (liquidation preference of \$64,020 at April 30, 2010 and \$64,120 at October 31, 2009)	59,857	59,950
Total Equity:		
Shareholders' equity	8	8

Edgar Filing: FUELCELL ENERGY INC - Form 10-Q

Common stock (\$.0001 par value); 150,000,000 shares authorized;  
85,265,076 and 84,387,741 shares issued and outstanding at April 30, 2010  
and October 31, 2009, respectively

Additional paid-in capital	631,793	631,296
Accumulated deficit	(630,474)	(599,960)
Accumulated other comprehensive income (loss)	11	(2)
Treasury stock, Common, at cost (5,679 shares at April 30, 2010 and October 31, 2009)	(53)	(53)
Deferred compensation	53	53
Total shareholders' equity	1,338	31,342
Noncontrolling interest in subsidiaries	(182)	
Total equity	1,156	31,342
Total liabilities and equity	\$ 137,942	\$ 162,688

See accompanying notes to consolidated financial statements.

**Table of Contents**

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

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

	<b>Three Months Ended</b>	
	<b>April 30,</b>	
	<b>2010</b>	<b>2009</b>
Revenues:		
Product sales and revenues	\$ 13,007	\$ 19,308
Research and development contracts	3,580	3,556
Total revenues	16,587	22,864
Costs and expenses:		
Cost of product sales and revenues	19,120	28,614
Cost of research and development contracts	3,267	2,837
Administrative and selling expenses	4,547	4,755
Research and development expenses	5,089	5,053
Total costs and expenses	32,023	41,259
Loss from operations	(15,436)	(18,395)
Interest expense	(45)	(66)
Loss from equity investment	(245)	(216)
Interest and other income, net	364	130
Loss before redeemable preferred stock of subsidiary	(15,362)	(18,547)
Accretion of redeemable preferred stock of subsidiary	(603)	(533)
Loss before provision for income taxes	(15,965)	(19,080)
Provision for income taxes	(13)	
Net loss	(15,978)	(19,080)
Net loss attributable to noncontrolling interest	96	
Net loss attributable to FuelCell Energy, Inc.	(15,882)	(19,080)
Preferred stock dividends	(800)	(802)

Edgar Filing: FUELCELL ENERGY INC - Form 10-Q

Net loss to common shareholders	\$ (16,682)	\$ (19,882)
Net loss per share to common shareholders		
Basic	\$ (0.20)	\$ (0.29)
Diluted	\$ (0.20)	\$ (0.29)
Weighted average shares outstanding		
Basic	84,515,979	69,521,575
Diluted	84,515,979	69,521,575

See accompanying notes to consolidated financial statements.



**Table of Contents**

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

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

	<b>Six Months Ended</b>	
	<b>April 30,</b>	
	<b>2010</b>	<b>2009</b>
Revenues:		
Product sales and revenues	\$ 25,815	\$ 38,339
Research and development contracts	5,388	6,248
Total revenues	31,203	44,587
Costs and expenses:		
Cost of product sales and revenues	37,133	57,551
Cost of research and development contracts	5,363	5,075
Administrative and selling expenses	8,703	9,001
Research and development expenses	9,709	10,790
Total costs and expenses	60,908	82,417
Loss from operations	(29,705)	(37,830)
Interest expense	(108)	(126)
Loss from equity investment	(393)	(562)
Interest and other income, net	683	545
Loss before redeemable preferred stock of subsidiary	(29,523)	(37,973)
Accretion of redeemable preferred stock of subsidiary	(1,160)	(1,026)
Loss before provision for income taxes	(30,683)	(38,999)
Provision for income taxes	(13)	
Net loss	(30,696)	(38,999)
Net loss attributable to noncontrolling interest	182	
Net loss attributable to FuelCell Energy, Inc.	(30,514)	(38,999)
Preferred stock dividends	(1,602)	(1,604)

Edgar Filing: FUELCELL ENERGY INC - Form 10-Q

Net loss to common shareholders	\$ (32,116)	\$ (40,603)
Net loss per share to common shareholders		
Basic	\$ (0.38)	\$ (0.59)
Diluted	\$ (0.38)	\$ (0.59)
Weighted average shares outstanding		
Basic	84,459,926	69,178,940
Diluted	84,459,926	69,178,940

See accompanying notes to consolidated financial statements.

**Table of Contents**

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

	<b>Six Months Ended</b>	
	<b>April 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (30,696)	\$ (38,999)
Adjustments to reconcile net loss to net cash used in operating activities:		
Share-based compensation	1,377	2,553
Loss from equity investment	393	562
Accretion of redeemable preferred stock of subsidiary	1,160	1,026
Interest receivable on loan to affiliate	(34)	(73)
Loss on derivatives	30	14
Depreciation	3,772	4,369
Amortization of bond premium	32	538
Provision (recovery) for doubtful accounts	40	(6)
(Increase) decrease in operating assets:		
Accounts receivable	4,770	1,743
Inventories	(4,851)	1,690
Other assets	1,197	375
Increase (decrease) in operating liabilities:		
Accounts payable	(3,492)	(7,880)
Accrued liabilities	2,135	216
Deferred revenue, royalty income and customer deposits	7,137	(7,412)
<b>Net cash used in operating activities</b>	<b>(16,496)</b>	<b>(41,284)</b>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(1,685)	(1,944)
Convertible loan to affiliate	(600)	(600)
Treasury notes matured	7,000	23,000
Treasury notes purchased	(19,670)	
<b>Net cash (used in) provided by investing activities</b>	<b>(14,955)</b>	<b>20,456</b>
<b>Cash flows from financing activities:</b>		
Repayment of debt	(205)	(120)
Proceeds from debt		436
Payment of preferred dividends	(1,917)	(1,864)
Net proceeds from sale of common stock		1,230
Common stock issued for stock plans and related expenses	(151)	178
<b>Net cash used in financing activities</b>	<b>(2,273)</b>	<b>(140)</b>

Effects on cash from changes in foreign currency rates	13	(4)
<b>Net decrease in cash and cash equivalents</b>	<b>(33,711)</b>	<b>(20,972)</b>
Cash and cash equivalents-beginning of period	57,823	38,043
<b>Cash and cash equivalents-end of period</b>	<b>\$ 24,112</b>	<b>\$ 17,071</b>
Supplemental cash flow disclosures:		
Cash interest paid	\$ 108	\$ 126
Noncash operating activity:		
Stock issued in settlement of prior year bonus obligation	\$ 673	\$ 926
See accompanying notes to consolidated financial statements.		

**Table of Contents**

**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 Summary of Significant Accounting Policies**

FuelCell Energy, Inc. and subsidiaries (the Company, FuelCell, we, us, or our) is a Delaware corporation engaged in the 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 been commercializing our stationary fuel cells and are beginning the development of planar solid oxide fuel cell and other fuel cell technologies. 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 April 30, 2010 have been included. All intercompany accounts and transactions have been eliminated.

Interim results are not necessarily indicative of the results to be expected for the full year. The information included in this Form 10-Q should be read in conjunction with information included in our Annual Report on Form 10-K for the year ended October 31, 2009 filed with the SEC.

***Use of Estimates***

The preparation of financial statements and related disclosures 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. Actual results could differ from those estimates. Estimates are used in accounting for, among other things, revenue recognition, contract loss reserves, excess, slow-moving and obsolete inventories, product warranty costs, reserves on long-term service agreements, share-based compensation expense, allowance for doubtful accounts, depreciation and amortization, long-lived asset impairments 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.

***Revenue Recognition***

We earn revenue from (i) the sale and installation of fuel cell power plants, modules and component parts to customers (i.e. product sales), (ii) providing services under long-term service agreements (LTSA), (iii) the sale of electricity under power purchase agreements (PPA), (iv) incentive revenue from the sale of electricity under PPAs, (v) site engineering and construction services and (vi) customer-sponsored research and development projects. Our revenue is primarily generated from customers located throughout the U.S. and Asia and from agencies of the U.S. government. Revenue from customer-sponsored research and development projects is recorded as research and development contracts revenue and all other revenues are recorded as product sales and revenues in the consolidated statements of operations.

**Table of Contents**

**FUELCELL ENERGY, INC.**

Notes to Consolidated Financial Statements

**(Unaudited)**

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

Revenue from sales of our DFC power plants and modules are recognized under the percentage of completion method of accounting. Revenues are recognized proportionally as costs are incurred and assigned to a customer contract by comparing total expected costs for each contract to the total contract value. Historically, we have not provided for a contract loss reserve on product sales contracts as products were in their early stages of development and market acceptance, and the total costs to produce, install and commission these units could not be reasonably estimated. As a result of a consistent production rate over the past two fiscal years and installation and commissioning experience for our major product lines, management now believes that it has sufficient product cost history to reasonably estimate the total costs of our fuel cell product sales contracts. Accordingly, effective November 1, 2009, a contract loss reserve on product sales contracts is recognized at the time we become aware that estimated total costs are expected to exceed the contract sales price. We have reviewed open contracts and recorded an estimated loss of \$0.2 million for the six months ended April 30, 2010. Actual results could vary from initial estimates and reserve estimates will be updated as we gain further manufacturing and operating experience. For component and spare parts sales, revenue is recognized upon shipment under the terms of the customer contract.

Revenue earned by performing routine monitoring and maintenance under LTSA s is recognized ratably over the term of the contract. For service contracts which include a minimum operating output over the course of the contract, a portion of the contract revenue is deferred until such time as it is earned through power plant performance.

Revenue from the sale of electricity is recognized as electricity is provided to the customer. Incentive revenue is recognized ratably over the term of the PPA. Site engineering and construction services revenue is recognized as costs are incurred.

Revenue from research and development contracts is recognized proportionally as costs are incurred and compared to the estimated total research and development costs for each contract. Revenue from government funded research, development and demonstration programs are generally multi-year, cost-reimbursement and/or cost-shared type contracts or cooperative agreements. We are reimbursed for reasonable and allocable costs up to the reimbursement limits set by the contract or cooperative agreement, and on certain contracts we are reimbursed only a portion of the costs incurred. While government research and development contracts may extend for many years, funding is often provided incrementally on a year-by-year basis if contract terms are met and Congress has authorized the funds.

***Warranty and Service Expense Recognition***

We warranty our products for a specific period of time against manufacturing or performance defects. Our warranty is limited to a term generally 15 months after shipment or 12 months after installation of our products. We reserve for estimated future warranty costs based on historical experience. Given our limited operating experience, particularly for newer product designs, actual results could vary from initial estimates. Estimates used to record warranty reserves are updated as we gain further operating experience.

In addition to the standard product warranty, we have entered into LTSA contracts with certain customers to provide monitoring, maintenance and repair services for fuel cell power plants ranging from one to 13 years. Our standard service agreement term is five years. Under the terms of our LTSA, the power plant must meet a minimum operating output during the term. If minimum output falls below the contract requirement, we may replace the customer s fuel cell stack with a new or used unit. Our contractual liability under LTSA s is limited to the amount of service fees payable under the contract. This can often times be less than the cost of a new stack replacement. In order to continue to meet customer expectations on early product designs, we have incurred costs in excess of our contractual liabilities.

**Table of Contents****FUELCELL ENERGY, INC.**

## Notes to Consolidated Financial Statements

**(Unaudited)**

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

LTSA s for power plants that have our five-year stack design are not expected to require a stack change to continue to meet minimum operating levels during the initial five-year term of the contract, although we have limited operating experience with these products. Stack replacements for new agreements which include the five-year stack design are expected to only be required upon renewal of the service agreement. We expect the replacement of older stacks produced prior to the five-year stack design will continue over the next several years, and as a result, we may incur losses in order to maintain power plants. Reserve estimates for future costs associated with maintaining legacy service agreements will be determined by a number of factors including the estimated life of the stack, used replacement stacks available, our limit of liability on service agreements and future operating plans for the power plant.

As our fuel cell products have been in their early stages of commercialization and market acceptance, we historically have provided for a pricing reserve if the agreement was sold below our standard pricing. As a result of our experience with these contracts and production rates of stacks and related costing, effective February 1, 2010, the method of estimating contract losses has been revised resulting in a \$0.5 million benefit to the consolidated statement of operations for the three months ended April 30, 2010. As of April 30, 2010, our reserve on LTSA contracts totaled \$4.9 million compared to \$6.0 million as of October 31, 2009. As noted under the revenue recognition policy, revenue allocable to meeting the performance requirements of the LTSA (which may include a new or used stack replacement) is deferred until it is earned. Deferred LTSA revenue as of April 30, 2010 totaled \$3.0 million compared to \$2.5 million as of October 31, 2009. We estimate that reserves and deferred revenues exceed our minimum contractual liabilities under our current contracts, however, LTSA pricing, reserves and revenue deferrals are based upon estimates of future costs, which given our products' early stage of commercialization could be materially different from actual expenses.

***Inventories and Advance Payments to Vendors***

Inventories consist principally of raw materials and work-in-process and are stated at the lower of cost or market. In certain circumstances, we will make advance payments to vendors for future inventory deliveries. These advance payments (net of related reserves) are recorded as other current assets on the consolidated balance sheets.

As we have historically sold products at or below cost, we have provided for a lower of cost or market ( LCM ) reserve to the cost basis of inventory. This reserve is computed by comparing the current sales prices of our fuel cell products to their estimated costs. As a result of a consistent production rate over the past two fiscal years and installation and commissioning experience for our major product lines, management now believes that it has sufficient product cost history to reasonably estimate the total costs of our fuel cell product sales contracts. During the second half of 2009, we began production of our newest megawatt-class power plants and modules. The manufactured cost per kilowatt of these products is lower than previous models due to a 17 percent power increase and lower component and raw materials cost.

***Concentrations***

We contract with a small number of customers for the sale of products and for research and development contracts. Our top two customers, POSCO Power ( POSCO ), which is a related party and owns approximately 13 percent of the outstanding common shares of the Company, and the U.S. government (primarily the Department of Energy), combined accounted for 86 percent and 83 percent of consolidated revenues for the three months ended April 30, 2010 and 2009, respectively, and 81 percent and 80 percent of consolidated revenues for the six months ended April 30, 2010 and 2009, respectively.

**Table of Contents**

**FUELCELL ENERGY, INC.**  
Notes to Consolidated Financial Statements  
(Unaudited)

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

The percent of consolidated revenues from each customer is presented below.

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
POSCO	64%	68%	64%	66%
U.S. Government	22%	15%	17%	14%
Combined	86%	83%	81%	80%

There can be no assurance that we will continue to achieve historical levels of sales of our products to our largest customers. Even though our customer base is expected to increase and our revenue streams to diversify, a substantial portion of net revenues could continue to depend on sales to a limited number of customers. Our agreements with these customers may be cancelled if we fail to meet certain product specifications or materially breach the agreement, and our customers may seek to renegotiate the terms of current agreements or renewals. The loss of, or reduction in sales to, one or more of our larger customers, could have a material adverse affect on our business, financial condition and results of operations.

**Subsequent Events**

We have evaluated subsequent events and transactions for potential recognition or disclosure in our financial statements prior to the issuance of the financial statements.

Subsequent to April 30, 2010 Pacific Gas and Electric (PG&E), one of the largest utilities in the United States, entered into contracts for 2.8MW of fuel cell power plants for installation at two different university campuses in California. The fuel cell power plants will be operational in 2011 and will be configured to utilize the byproduct heat for use by the university facilities, increasing the overall efficiency of the power plants. These contracts will add approximately \$12.6 million to product sales backlog. The Company issued letters of credit to PG&E totaling approximately \$6.3 million as security for the Company's performance during the installation period of the contracts. These letters of credit expire in April 2012 and may be reduced in value as the Company achieves substantial completion of the installation contract milestones.

Subsequent to April 30, 2010, the Company entered into an agreement with Marubeni Corporation to return certain advance contract payments, resolve claims for services and repurchase surplus inventory items previously sold to Marubeni Corporation. The agreement calls for payments of approximately \$1.9 million to Marubeni Corporation over the next three fiscal quarters and a payment of \$1.0 million upon title transfer of surplus inventory to FuelCell. The Company has a balance of approximately \$3.2 million included in deferred revenue, royalty income and customer deposits on its consolidated balance sheet related to these contracts and does not expect to incur charges to the consolidated statement of operations as a result of this agreement.

**Comprehensive Loss**

Comprehensive loss for the periods presented was as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Net loss attributable to FuelCell	\$ (15,882)	\$ (19,080)	\$ (30,514)	\$ (38,999)
Foreign currency translation adjustments	5	(4)	13	(4)



Comprehensive loss	\$ (15,877)	\$ (19,084)	\$ (30,501)	\$ (39,003)
--------------------	-------------	-------------	-------------	-------------

**Liquidity**

Our future liquidity will be dependent on obtaining the order volumes and cost reductions necessary to achieve profitable operations. We may also raise capital through debt or equity offerings; however, there can be no assurance that we will be able to obtain additional capital in the future. The timing and size of any financing will depend on multiple factors including market conditions, future order flow and the need to adjust production capacity. If we are unable to raise additional capital, our growth potential may be adversely affected and we may have to modify our plans.

**Recently Adopted Accounting Guidance**

In February 2010, the Financial Accounting Standards Board ( FASB ) issued amended guidance relating to the disclosure of subsequent events. Under previous guidance, SEC registrants were required to evaluate subsequent events through the date the financial statements were issued, or available for issuance, and disclose in its public filings the date through which subsequent events were evaluated. Under the amended guidance, SEC registrants are required to evaluate subsequent events through the date the financial statements are issued (rather than the date the financial statements are available for issuance), but are no longer required to disclose in its public filings the date through which subsequent events were evaluated. The amended guidance is effective immediately and has been adopted and reflected in our financial statements.

**Table of Contents**

**FUELCELL ENERGY, INC.**

Notes to Consolidated Financial Statements

**(Unaudited)**

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

In April 2008, the FASB issued accounting guidance that amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. In developing assumptions about renewal or extension options used to determine the useful life of an intangible asset, a company needs to consider its own historical experience adjusted for company-specific factors. In the absence of that experience, the company shall consider the assumptions that market participants would use about renewal or extension options. The new guidance was effective for the first quarter of fiscal 2010. We currently do not have any intangible assets recorded in our consolidated balance sheets; therefore, the impact of this guidance on our consolidated financial statements will be determined when and if we acquire definite-lived intangible assets.

In December 2007, the FASB issued revised accounting guidance for business combinations that requires an acquirer to measure the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at their fair values on the acquisition date, with goodwill being the excess value over the net identifiable assets acquired. The guidance also requires that certain other assets and liabilities related to the acquisition, such as contingencies and research and development, be recorded at fair value. The new guidance was effective for the first quarter of fiscal 2010. The potential impact of this revised guidance on our consolidated financial statements will be based upon future business combinations, if any.

In December 2007, the FASB issued new guidance that requires noncontrolling interests (formerly minority interests ) in a subsidiary be reported as equity in the consolidated financial statements. Consolidated net income should include the net income for both the parent and the noncontrolling interest with disclosure of both amounts in the consolidated statements of operations. The calculation of earnings per share would continue to be based on income amounts attributable to the parent. This guidance became effective in the first quarter of fiscal 2010 and changed the accounting for and reporting of noncontrolling interests in our subsidiaries.

Our consolidated financial statements include the accounts and operations of Alliance Monterrey, LLC; Alliance Chico, LLC; Alliance Star Energy, LLC; and Alliance TST Energy, LLC (collectively, the Alliance Entities ). Each of the Alliance Entities is a joint venture with Alliance Power, Inc. ( Alliance ) established to construct fuel cell power plants and sell power under power purchase agreements. We have an 80 percent interest in each entity and accordingly, the financial results of the Alliance Entities are consolidated with our financial results.

Each of the Alliance Entities has a capital deficit as they have historically operated at a loss. Under previous accounting guidance, we absorbed the noncontrolling interest s share of these losses because the noncontrolling interest was under no obligation to repay these losses. If the Alliance Entities generated future earnings, we would be credited to the extent of the noncontrolling interest s losses previously absorbed. Additionally, the consolidated balance sheets did not reflect the noncontrolling interest s share of the capital deficit of the Alliance Entities. Under the new accounting guidance, the noncontrolling interest s share of the losses is reflected in the consolidated statements of operations and its share of the capital deficit of the Alliance Entities is reflected as equity in the consolidated balance sheets.

The prior period financial statements have not been adjusted as our noncontrolling interests holders have always been in a deficit position. The proforma impact on the total equity section of our consolidated balance sheet as of October 31, 2009 had this guidance been required for that period would have been a \$1.9 million reduction in accumulated deficit in total shareholders equity and an increase in the deficit position for noncontrolling interest in subsidiaries. Had this guidance been required for the prior year periods, net loss attributable to common shareholders would have been \$0.1 million and \$0.3 million lower for the three and six months ended April 30, 2009, respectively, and basic and diluted net loss per share attributable to common shareholders would have been \$(0.28) and \$(0.58) for three and six months ended April 30, 2009, respectively.



**Table of Contents**

**FUELCELL ENERGY, INC.**

Notes to Consolidated Financial Statements

**(Unaudited)**

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

***Recent Accounting Guidance Not Yet Effective***

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. This guidance is effective prospectively for milestones achieved in fiscal years beginning on or after June 15, 2010. While we are still analyzing the potential impact of this guidance, we believe that our current practices are consistent with the guidance and, accordingly, we do not expect the adoption of this guidance will have a material impact on our financial statements.

In March 2010, the FASB issued guidance clarifying that embedded credit-derivative features related only to the transfer of credit risk in the form of subordination of one financial instrument to another are not subject to potential bifurcation and separate accounting. Other embedded credit-derivative features are required to be analyzed to determine whether they must be accounted for separately. The guidance is effective at the beginning of a company's first fiscal quarter beginning after June 15, 2010 and may be early adopted in a company's first fiscal quarter beginning after March 5, 2010 (the issuance date of the guidance). We currently do not enter into contracts containing embedded credit-derivative features related only to the transfer of credit risk in the form of subordination of one financial instrument to another; and therefore, do not expect the adoption of this guidance will have a material impact on our financial statements or disclosures.

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 requires disclosures about inputs and valuation techniques used to measure fair value as well as disclosures about significant transfers in and out of Level 1 and Level 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.

**Table of Contents**

**FUELCELL ENERGY, INC.**  
Notes to Consolidated Financial Statements  
**(Unaudited)**

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

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. The guidance is effective as of the beginning of a company s first fiscal year beginning after November 15, 2009 (November 1, 2010 for the Company), and for subsequent interim and annual reporting periods. We are evaluating the impact of adopting this guidance.

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. The guidance will be effective prospectively for revenue arrangements entered into or materially modified on or after June 15, 2010, with early adoption permitted. We are evaluating the impact of adopting this guidance.

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. The guidance will be effective for the first quarter of fiscal 2011. We are evaluating the impact of adopting this guidance.

***Health Care Reform Acts***

In March 2010, the President of the United States signed the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively the 2010 Acts ). The 2010 Acts will have a substantial impact on health care providers, insurers, employers and individuals. The 2010 Acts will impact employers and businesses differently depending on the size of the organization and the specific impacts on a company s employees. Certain provisions of the 2010 Acts will become effective with our next open enrollment period (November 1, 2010) while other provisions of the 2010 Acts will be effective in future years. The 2010 Acts could require, among other things, changes to our current employee benefit plans, our information technology infrastructure, and in our administrative and accounting processes. The ultimate extent and cost of these changes cannot be determined at this time and are being evaluated and updated as related regulations and interpretations of the 2010 Acts become available.

**Table of Contents****FUELCELL ENERGY, INC.**

## Notes to Consolidated Financial Statements

**(Unaudited)**

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

**Note 2. Investments**

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 April 30, 2010 and October 31, 2009:

	<b>Amortized Cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized (losses)</b>	<b>Fair Value</b>
<b><i>U.S. Government Obligations</i></b>				
As of April 30, 2010	\$ 19,642	\$	\$ (15)	\$ 19,627
As of October 31, 2009	\$ 7,004	\$ 40	\$	\$ 7,044

The following table summarizes the contractual maturities of investments at amortized cost and fair value as of April 30, 2010:

	<b>Amortized Cost</b>	<b>Fair Value</b>	<b>Weighted average yield to maturity</b>
Due within one year	\$ 3,012	\$ 3,012	0.9%
Due after one year	16,630	16,615	1.2%
Total investments	\$ 19,642	\$ 19,627	1.1%

**Note 3. Accounts Receivable**

Accounts receivable at April 30, 2010 and October 31, 2009 consisted of the following:

	<b>April 30, 2010</b>	<b>October 31, 2009</b>
U.S. Government:		
Amount billed	\$ 1,028	\$ 574
Unbilled recoverable costs	689	776
	1,717	1,350
Commercial Customers:		
Amount billed	4,734	5,439
Unbilled recoverable costs	11,659	16,131
	16,393	21,570
	\$ 18,110	\$ 22,920

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 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 \$0.05 million and \$0.02 million

at April 30, 2010 and October 31, 2009, respectively.

**Table of Contents****FUELCELL ENERGY, INC.**

## Notes to Consolidated Financial Statements

**(Unaudited)**

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

**Note 4. Inventories**

Inventories are stated at the lower of cost or market price. The components of inventory at April 30, 2010 and October 31, 2009 consisted of the following:

	April 30, 2010	October 31, 2009
Raw materials	\$ 14,366	\$ 14,583
Work-in-process	23,027	19,790
Gross inventory	37,393	34,373
Less amount to reduce certain inventories to lower of cost or market	(7,109)	(8,940)
Net inventory	\$ 30,284	\$ 25,433

**Note 5. Property, Plant and Equipment**

Property, plant and equipment are stated at cost, less accumulated depreciation provided on the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized on the straight-line method over the shorter of the estimated useful lives of the assets or the term of the lease. Property, plant and equipment at April 30, 2010 and October 31, 2009 consisted of the following:

	April 30, 2010	October 31, 2009	Estimated Useful Life
Land	\$ 524	\$ 524	
Building and improvements	6,875	6,851	10-26 years
Machinery, equipment and software	60,508	59,860	3-8 years
Furniture and fixtures	2,614	2,604	10 years
Power plants for use under PPAs	17,743	17,743	10 years
Construction in progress <sup>(1)</sup>	7,695	6,710	
	95,959	94,292	
Less, accumulated depreciation and amortization	(65,645)	(61,898)	
Property, plant and equipment, net	\$ 30,314	\$ 32,394	

(1) Included in construction in progress are costs of \$0.9 million and \$0.8 million at April 30, 2010



and October 31,  
2009,  
respectively, to  
build power  
plants that will  
service power  
purchase  
agreement  
contracts.

Depreciation expense was \$3.8 million and \$4.4 million, for the six months ended April 30, 2010 and 2009, respectively.

**Note 6. Investment in and Loans to Affiliate**

Versa Power Systems, Inc. ( Versa ) is one of our sub-contractors under the Department of Energy s large-scale hybrid project to develop a coal-based, multi-megawatt solid oxide fuel cell-based ( SOFC ) system. Versa is a private company founded in 2001 that has been developing advanced SOFC systems for various stationary and mobile applications.

During the second quarter, we invested \$0.6 million in Versa in the form of a convertible note and received warrants for the right to purchase 861 shares of common stock with an exercise price of \$139 per share. As of April 30, 2010, we own 77,140 shares of Versa common stock, representing 39 percent of Versa s outstanding common shares. In addition, we have convertible loans receivable from Versa of \$3.2 million and hold warrants for the right to purchase a total of 3,969 shares of Versa common stock at a weighted average price of \$161 per share. Should the convertible notes and warrants be converted, our total ownership interest in Versa would increase to 45 percent.

**Table of Contents**

**FUELCELL ENERGY, INC.**  
Notes to Consolidated Financial Statements  
(Unaudited)

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

We account for Versa under the equity method of accounting and recognize our share of the losses as loss from equity investments on the consolidated statements of operations. We recorded losses from Versa of \$0.2 million and \$0.4 million during the three and six months ended April 30, 2010, respectively, and \$0.2 million and \$0.6 million during the three and six months ended April 30, 2009, respectively. Our total investment in and loans to Versa was \$10.3 million and \$10.1 million as of April 30, 2010 and October 31, 2009, respectively.

**Note 7. Accrued Liabilities**

Accrued liabilities at April 30, 2010 and October 31, 2009 consisted of the following:

	April 30, 2010	October 31, 2009
Accrued payroll and employee benefits	\$ 3,075	\$ 3,258
Accrued contract and operating costs <sup>(1)</sup>	4,108	3,190
Reserve for product warranty costs <sup>(2)</sup>	1,919	500
Reserve for long-term service agreement costs	4,922	5,950
Accrued taxes and other	1,003	910
<b>Total</b>	<b>\$ 15,027</b>	<b>\$ 13,808</b>

(1) Includes \$2.8 million and \$2.2 million at April 30, 2010 and October 31, 2009, respectively, potentially owed to customers related to contract performance.

(2) Activity in the reserve for product warranty costs during the six months ended April 30, 2010 included additions for specific known warranty issues

totaling  
 \$1.5 million,  
 other general  
 reserve  
 additions for  
 estimates of  
 potential future  
 warranty  
 obligations of  
 \$1.0 million on  
 contracts in the  
 warranty period  
 and reserve  
 reductions of  
 \$1.1 million as  
 contracts  
 progress  
 through the  
 warranty period  
 or are beyond  
 the warranty  
 period.

**Note 8. Debt**

At April 30, 2010 and October 31, 2009, debt consisted of the following:

	<b>April 30, 2010</b>	<b>October 31, 2009</b>
Connecticut Development Authority Note	\$ 3,917	\$ 4,000
Connecticut Clean Energy Fund Note	679	650
Capitalized lease obligations	215	321
Total debt	4,811	4,971
Less current portion	(984)	(997)
Long-term debt	\$ 3,827	\$ 3,974

The Connecticut Development Authority note bears interest at 5 percent and the loan is collateralized by the assets procured under this loan as well as \$4.0 million of additional machinery and equipment. The note matures May 2018.

**Table of Contents****FUELCELL ENERGY, INC.**

## Notes to Consolidated Financial Statements

**(Unaudited)**

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

The Connecticut Clean Energy Fund note is an agreement between Bridgeport Fuel Cell Park, LLC ( BFCP ), a wholly owned subsidiary, and the Connecticut Clean Energy Fund, the proceeds of which were designated for pre-development expenses associated with the development, construction and operation of a fuel cell generation facility in Bridgeport, Connecticut (the Project ). Interest accrues monthly at an annual rate of 8.75 percent. Repayment of principal and any accrued and unpaid interest is required on the earliest occurrence of any of the following events: (a) twelve months after the commencement date of the commercial operation of the Project, (b) the date of closing of permanent institutional financing of the Project, (c) the date of any sale of the Project and (d) the date upon which certain change in control events occur related to BFCP. The note is secured by assets of BFCP. We have not made any payments as of April 30, 2010, and the note is classified as currently payable as the timing of events that would result in repayment are not determinable.

We lease computer equipment under a \$2.5 million master lease agreement. Lease payment terms are thirty-six months from the date of acceptance for leased equipment.

**Note 9. Share-Based Compensation Plans**

We have shareholder approved equity incentive plans and a shareholder approved Section 423 Stock Purchase Plan (the ESPP ). Under the equity incentive plans, the board is authorized to grant incentive stock options, nonqualified stock options, restricted stock awards ( RSA ) and stock appreciation rights ( SARs ) to our officers, key employees and non-employee directors. 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 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 April 30, 2010 and 2009 was as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Cost of product sales and revenues	\$ 168	\$ 210	\$ 392	\$ 515
Cost of research and development contracts	38	49	77	102
General and administrative expense	372	661	566	1,495
Research and development expense	156	180	341	425
Total share-based compensation	\$ 734	\$ 1,100	\$ 1,376	\$ 2,537

Activity under our equity incentive plans for the six months ended April 30, 2010 was as follows:

	<b>Stock Options</b>		<b>Restricted Stock Awards</b>	
	<b>Number of</b>	<b>Weighted</b>	<b>Number of</b>	<b>Weighted</b>
	<b>options</b>	<b>average</b>	<b>RSAs</b>	<b>average</b>
		<b>price (\$)</b>		<b>price (\$)</b>
Outstanding at October 31, 2009	5,740,705	10.86	593,262	2.88
Granted	171,139	2.89	700,231	2.79
Exercised / Vested			(135,417)	2.85
Cancelled	(655,018)	11.76	(20,500)	2.85

Edgar Filing: FUELCELL ENERGY INC - Form 10-Q

Outstanding at April 30, 2010	5,256,826	10.56	1,137,576	2.83
-------------------------------	-----------	-------	-----------	------

**Table of Contents****FUELCELL ENERGY, INC.**

## Notes to Consolidated Financial Statements

**(Unaudited)**

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

Activity under our ESPP for the six months ended April 30, 2010 was as follows:

	<b>Number of Shares</b>
Balance at October 31, 2009	207,207
Issued @ \$2.70	(39,858)
Balance at April 30, 2010	167,349

**Note 10. Conversion of Preferred Stock**

During the six months ended April 30, 2010, 100 shares of Series B redeemable preferred stock, with a book value of \$93,000 net of original issuance costs, were converted into 8,510 shares of common stock.

**Note 11. Equity**

Changes in total equity for the six months ended April 30, 2010 was as follows:

	<b>Total Shareholders Equity</b>	<b>Noncontrolling interest</b>	<b>Total Equity</b>
Balance at October 31, 2009	\$ 31,342	\$	\$ 31,342
Share-based compensation	1,377		1,377
Stock issued under benefit plans	628		628
Preferred dividends Series B	(1,602)		(1,602)
Conversion of Series B preferred stock to common stock, net of original issuance costs	93		93
Effect of foreign currency translation	14		14
Net loss	(30,514)	(182)	(30,696)
Balance at April 30, 2010	\$ 1,338	\$ (182)	\$ 1,156

**Table of Contents****FUELCELL ENERGY, INC.**

## Notes to Consolidated Financial Statements

**(Unaudited)**

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

**Note 12. Net Loss Per Share**

The calculation of basic and diluted net loss per share was as follows:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Numerator				
Net loss	\$ (15,978)	\$ (19,080)	\$ (30,696)	\$ (38,999)
Net loss attributable to noncontrolling interest	96		182	
Preferred stock dividend	(800)	(802)	(1,602)	(1,604)
Net loss to common shareholders	\$ (16,682)	\$ (19,882)	\$ (32,116)	\$ (40,603)
Denominator				
Weighted average basic common shares	84,515,979	69,521,575	84,459,926	69,178,940
Effect of dilutive securities <sup>(1)</sup>				
Weighted average diluted common shares	84,515,979	69,521,575	84,459,926	69,178,940
Basic loss per share	\$ (0.20)	\$ (0.29)	\$ (0.38)	\$ (0.59)
Diluted loss per share <sup>(1)</sup>	\$ (0.20)	\$ (0.29)	\$ (0.38)	\$ (0.59)

(1) Diluted loss per share was computed without consideration to potentially dilutive instruments as their inclusion would have been antidilutive. Potentially dilutive instruments include stock options, warrants and convertible

preferred stock.  
At April 30,  
2010 and 2009,  
there were  
options to  
purchase  
5.3 million and  
6.0 million  
shares of  
common stock,  
respectively.  
There were no  
outstanding  
warrants as of  
April 30, 2010  
and 0.5 million  
outstanding  
warrants at  
April 30, 2009.  
Refer to our  
Annual Report  
on Form 10-K  
for the year  
ended  
October 31,  
2009 for  
information on  
our convertible  
preferred stock.

**Note 13. Commitments and Contingencies**

We have pledged approximately \$2.4 million of our cash and cash equivalents as collateral and letters of credit for certain banking requirements and contracts. As of April 30, 2010, outstanding letters of credit totaled \$0.9 million. These expire on various dates through January 2011. Refer to Subsequent Events in Note 1 for additional information.



**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) is provided as a supplement to the accompanying financial statements and footnotes to help provide an understanding of our financial condition, changes in our financial condition and results of operations. The following discussion should be read in conjunction with information included in our Annual Report on Form 10-K for the year ended October 31, 2009 filed with the Securities and Exchange Commission ( SEC ). Unless otherwise indicated, the terms Company , FuelCell Energy , we , us , and our refer to FuelCell Energy Inc. and its subsidiaries. All tabular dollar amounts are in thousands. The MD&A is organized as follows:

**Caution concerning forward-looking statements.** This section discusses how certain forward-looking statements made by us throughout the MD&A are based on management's present expectations about future events and are inherently susceptible to uncertainty and changes in circumstances.

**Overview and recent developments.** This section provides a general description of our business. We also briefly summarize any significant events occurring subsequent to the close of the reporting period.

**Results of operations.** This section provides an analysis of our results of operations for the three and six months ended April 30, 2010 and 2009. In addition, a description is provided of transactions and events that impact the comparability of the results being analyzed.

**Liquidity and capital resources.** This section provides an analysis of our cash position and cash flows.

**Critical accounting policies and estimates.** This section discusses those accounting policies and estimates that are both considered important to our financial condition and operating results and require significant judgment and estimates on the part of management in their application.

**Recent accounting guidance.** This section summarizes recently issued accounting guidance and its potential impact on our financial statements and disclosures.

**CAUTION CONCERNING FORWARD-LOOKING STATEMENTS**

In addition to historical information, this MD&A contains forward-looking statements. All forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. Factors that could cause such a difference include, without limitation, general risks associated with product development, manufacturing, changes in the regulatory environment, customer strategies, potential volatility of energy prices, rapid technological change, competition, and the ability to achieve our sales plans and cost reduction targets, as well as other risks set forth under Part II. Item 1A Risk Factors in this report.

**OVERVIEW AND RECENT DEVELOPMENTS**

**Overview**

We are a world leader in the development and production of stationary fuel cells for commercial, industrial, government, and utility customers. Our ultra-clean and high efficiency power plants are generating power at over 50 locations worldwide. Our products have generated over 500 million kilowatt hours (kWh) of power using a variety of fuels including renewable wastewater gas, food and beverage waste, natural gas and other hydrocarbon fuels.

Our power plants offer higher-efficiency stationary power generation for customers. In addition to our commercial products, we continue to develop our carbonate fuel cells, planar solid oxide fuel cell technology and other fuel cell technologies with our own and government research and development funds.

**Table of Contents**

Our proprietary carbonate power plants electrochemically (without combustion) produce electricity directly from readily available hydrocarbon fuels such as natural gas and biogas. Customers buy fuel cells to reduce cost and pollution, and improve power reliability. Electric generation without combustion significantly reduces harmful pollutants such as NOX and particulates. Higher fuel efficiency results in lower emissions of carbon dioxide ( CO<sub>2</sub> ), a major greenhouse gas, and also results in less fuel needed per kWh of electricity generated and Btu of heat produced. Greater efficiency reduces customers' exposure to volatile fuel costs and minimizes operating costs. Our fuel cells operate 24/7 providing reliable power to both on-site customers and for grid-support applications.

Compared to other power generation technologies, our products offer significant advantages including:

- Near-zero toxic emissions;
- High fuel efficiency;
- Ability to site units locally as distributed power generation;
- Potentially lower cost power generation;
- Byproduct heat ideal for cogeneration applications;
- Reliable, 24/7 base load power;
- Quiet operation; and
- Fuel flexibility.

Typical customers for our products include manufacturers, mission critical institutions such as correction facilities and government installations, hotels, natural gas letdown stations and customers who can use renewable gas for fuel such as breweries, food processors and wastewater treatment facilities. Our megawatt-class products are also used to supplement the grid for utility customers. With increasing demand for renewable and ultra-clean power options and increased volatility in electric markets, our customers gain control of power generation economics, reliability, and emissions.

***Recent Developments***

Subsequent to April 30, 2010 Pacific Gas and Electric (PG&E), one of the largest utilities in the United States, entered into contracts for 2.8MW of fuel cell power plants for installation at two different university campuses in California. The fuel cell power plants will be operational in 2011 and will be configured to utilize the byproduct heat for use by the university facilities, increasing the overall efficiency of the power plants. These contracts will add approximately \$12.6 million to product sales backlog. The Company issued letters of credit to PG&E totaling approximately \$6.3 million as security for the Company's performance during the installation period of the contracts. These letters of credit expire in April 2012 and may be reduced in value as the Company achieves substantial completion of the installation contract milestones.

**Table of Contents****RESULTS OF OPERATIONS**

Management evaluates the results of operations and cash flows using a variety of key performance indicators including revenues compared to prior periods and internal forecasts, costs of our products and results of our cost-out initiatives, and operating cash use. These are discussed throughout the Results of Operations and Liquidity and Capital Resources sections.

**Comparison of Three Months Ended April 30, 2010 and April 30, 2009****Revenues and Costs of revenues**

Our revenues and cost of revenues for the three months ended April 30, 2010 and 2009 were as follows:

	<b>Three Months Ended April 30,</b>		<b>Change</b>	
	<b>2010</b>	<b>2009</b>	<b>\$</b>	<b>%</b>
<b>Revenues:</b>				
Product sales and revenues <sup>(1)</sup>	\$ 13,007	\$ 19,308	\$ (6,301)	(33)
Research and development contracts	3,580	3,556	24	1
Total	\$ 16,587	\$ 22,864	\$ (6,277)	(27)
<b>Cost of revenues:</b>				
Product sales and revenues <sup>(2)</sup>	\$ 19,120	\$ 28,614	\$ (9,494)	(33)
Research and development contracts	3,267	2,837	430	15
Total	\$ 22,387	\$ 31,451	\$ (9,064)	(29)
<b>Gross Margin:</b>				
Product sales and revenues	\$ (6,113)	\$ (9,306)	\$ 3,193	34
Research and development contracts	313	719	(406)	(57)
Total	\$ (5,800)	\$ (8,587)	\$ 2,787	32