FUEL TECH, INC.
Form 10-Q
November 06, 2014

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

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

For the quarterly period ended September 30, 2014

or

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

For the transition period from to

Commission file number: 001-33059

FUEL TECH, INC.
(Exact name of registrant as specified in its charter)

Delaware	20-5657551
(State or other jurisdiction of incorporation of organization)	(I.R.S. Employer Identification Number)

Fuel Tech, Inc.
27601 Bella Vista Parkway
Warrenville, IL 60555-1617
630-845-4500
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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 x 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 definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	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 x

On November 6, 2014 there were outstanding 22,835,325 shares of Common Stock, par value $0.01 per share, of the registrant.

FUEL TECH, INC.
Form 10-Q for the nine-month period ended September 30, 2014
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$15,543	$27,738
Marketable securities	35	30
Accounts receivable, net of allowance for doubtful accounts of $966 and $1,189, respectively	34,816	36,974
Inventories	1,118	443
Prepaid expenses and other current assets	4,150	2,196
Prepaid income taxes	2,362	1,407
Deferred income taxes	290	477
Total current assets	58,314	69,265
Property and equipment, net of accumulated depreciation of $21,400 and $20,077, respectively	13,579	13,027
Goodwill	26,139	21,051
Other intangible assets, net of accumulated amortization of $6,193 and $5,108, respectively	10,616	4,305
Other assets	1,294	2,410
Total assets	$109,942	$110,058
Liabilities and Shareholders' Equity		
Current liabilities:		
Short-term debt	$1,624	$1,636
Accounts payable	9,073	9,920
Accrued liabilities:		
Employee compensation	1,641	4,460
Other accrued liabilities	6,530	4,630
Total current liabilities	18,868	20,646
Deferred income taxes	1,310	59
Other liabilities	531	730
Total liabilities	20,709	21,435
Shareholders' equity:		
Common stock, $.01 par value, 40,000,000 shares authorized, 22,993,435 and 22,701,613 shares issued, and 22,835,325 and 22,592,956 shares outstanding, respectively	230	227
Additional paid-in capital	134,774	132,796
Accumulated deficit	(44,641)	(44,027)
Accumulated other comprehensive (loss) income	(453)	37
Nil coupon perpetual loan notes	76	76

Treasury stock, 158,110 and 108,657 shares in 2014 and 2013, respectively, at cost	(753)	(486)
Total shareholders' equity	89,233	88,623
Total liabilities and shareholders' equity	$109,942	$110,058

See notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues	$21,482	$33,555	$60,333	$85,131
Costs and expenses:				
Cost of sales	11,582	18,455	34,069	48,734
Selling, general and administrative	8,080	9,304	25,783	27,069
Research and development	379	461	848	1,824
	20,041	28,220	60,700	77,627
Operating income (loss)	1,441	5,335	(367)	7,504
Interest expense	(33)	(19)	(96)	(29)
Interest income	6	14	23	43
Other expense	(285)	(82)	(354)	(291)
Income (loss) before income taxes	1,129	5,248	(794)	7,227
Income tax benefit (expense)	63	(1,768)	180	(2,532)
Net income (loss)	$1,192	$3,480	$(614)	$4,695
Net income (loss) per common share:				
Basic	$0.05	$0.16	$(0.03)	$0.21
Diluted	$0.05	$0.15	$(0.03)	$0.21
Weighted-average number of common shares outstanding:				
Basic	22,835,000	22,376,000	22,764,000	22,229,000
Diluted	23,216,000	22,534,000	22,764,000	22,458,000

See notes to consolidated financial statements.

FUEL TECH, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income (loss)	$1,192	$3,480	$(614)	$4,695
Other comprehensive (loss) income:				
Foreign currency translation adjustments	(135)	162	(493)	439
Unrealized (losses) gains from marketable securities, net of tax	(12)	2	3	(10)
Total other comprehensive (loss) income	(147)	164	(490)	429
Comprehensive income (loss)	$1,045	$3,644	$(1,104)	$5,124

See notes to consolidated financial statements.

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

	Nine Months Ended September 30,	
	2014	2013
Operating Activities		
Net (loss) income	$(614)	$4,695
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation	1,372	1,662
Amortization	1,034	636
Allowance for doubtful accounts	(205)	475
Deferred income taxes	(82)	(16)
Stock-based compensation	1,694	1,207
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	4,291	(13,333)
Inventories	(617)	(19)
Prepaid expenses, other current assets and other non-current assets	(874)	1,708
Accounts payable	(1,805)	1,489
Accrued liabilities and other non-current liabilities	(2,791)	880
Net cash provided by (used in) operating activities	1,403	(616)
Investing Activities		
Purchases of property, equipment and patents	(2,141)	(1,611)
Payment for intangible assets	(3,010)	—
Payment for acquisitions, net of cash acquired	(8,079)	—
Net cash used in investing activities	(13,230)	(1,611)
Financing Activities		
Proceeds on short-term borrowings	—	1,608
Proceeds from exercises of stock options	297	—
Excess tax benefit from exercises of stock options	7	—
Treasury shares withheld	(267)	(351)
Net cash provided by financing activities	37	1,257
Effect of exchange rate fluctuations on cash	(405)	189
Net decrease in cash and cash equivalents	(12,195)	(781)
Cash and cash equivalents at beginning of period	27,738	24,453
Cash and cash equivalents at end of period	$15,543	$23,672

See notes to consolidated financial statements.

FUEL TECH, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2014
(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, Compensation, and Nominating and Corporate Governance 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 NOxOUT-CASCADE®, ULTRA™ and NOxOUT-SCR® processes, Ammonia Injection Grid (AIG) and Graduated Straightening Grid (GSG™), as well as Electrostatic Precipitator rebuilds and Flue Gas Conditioning systems to control particulate emissions. 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 (PM2.5), 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 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 balance sheet at December 31, 2013 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, 2013 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, and supplies. 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. Such revisions have historically not had a material effect on the amount of revenue recognized. The completed contract method is used for certain contracts that are not long-term in nature or 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 September 30, 2014 and December 31, 2013, the Company had one and three contracts in progress, respectively, that were identified as a loss contracts and a provision for loss in the amount of $16 and $68, respectively, were recorded in other accrued liabilities on the consolidated balance sheets.

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; typically all performance guarantees and equipment warranties granted by us are voidable 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 September 30, 2014 and December 31, 2013, unbilled receivables were approximately $11,458 and $12,599, respectively, and are included in accounts receivable on the consolidated balance sheets. Billings in excess of costs and estimated earnings on uncompleted contracts were $1,362 and $1,206, at September 30, 2014 and December 31, 2013, respectively. Such amounts are included in other accrued liabilities on the consolidated balance sheets.

Fuel Tech has installed over 800 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: Available-for-Sale Marketable Securities

At the time of purchase, marketable securities are classified as available-for-sale as management has the intent and ability to hold such securities for an indefinite period of time, but not necessarily to maturity. Any decision to sell available-for-sale securities would be based on various factors, including, but not limited to asset/liability management strategies, changes in interest rates or prepayment risks, and liquidity needs. Available-for-sale securities are carried at fair value with unrealized gains and losses, net of related deferred income taxes, recorded in equity as a separate component of other comprehensive income (OCI). Our marketable securities consist of a single equity investment with a fair value of $35 and $30 and no cost basis at September 30, 2014 and December 31, 2013, respectively.

Purchases and sales of securities are recognized on a trade date basis. Realized securities gains or losses are reported in other income/(expense) in the Consolidated Statements of Operations. The cost of securities sold is based on the specific identification method. On a quarterly basis, we make an assessment to determine if there have been any events or circumstances to indicate whether a security with an unrealized loss is impaired on an other-than-temporary (OTTI) basis. This determination requires significant judgment. OTTI is considered to have occurred (1) if management intends to sell the security; (2) if it is more likely than not we will be required to sell the security before recovery of its amortized cost basis; or (3)the present value of the expected cash flows is not sufficient to recover the entire amortized cost basis. The credit-related OTTI, represented by the expected loss in principal, is recognized in non-interest income, while noncredit-related OTTI is recognized in OCI. For securities which we do expect to sell, all OTTI is recognized in earnings. Presentation of OTTI is made in the income statement on a gross basis with a reduction for the amount of OTTI recognized in OCI. Once an other-than-temporary impairment is recorded, when future cash flows can be reasonably estimated, future cash flows are re-allocated between interest and principal cash flows to provide for a level-yield on the security. We have not experienced any other-than-temporary impairments during the periods ended September 30, 2014 and 2013.

Note G: Accumulated Other Comprehensive Loss

The changes in accumulated other comprehensive (loss) income by component were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Foreign currency translation				
Balance at beginning of period	$(340)	$(142)	$18	$(419)
Other comprehensive loss:				
Foreign currency translation adjustments (1)	(135)	162	(493)	439
Balance at end of period	$(475)	$20	$(475)	$20
Available-for-sale marketable securities				
Balance at beginning of period	$34	$15	$19	$27
Other comprehensive income:				
Net unrealized holding gain (2)	(20)	4	5	(16)
Deferred income taxes (2)	8	(2)	(2)	6
Total other comprehensive income	(12)	2	3	(10)
Balance at end of period	$22	$17	$22	$17
Total accumulated other comprehensive loss	$(453)	$37	$(453)	$37

(1) In all periods presented, there were no tax impacts related to rate changes and no amounts were reclassified to earnings.

(2) In all periods presented, there were no realized holding gains or losses and therefore no amounts were reclassified to earnings.

Note H: Treasury Stock

Common stock held in treasury totaled 158,110 and 108,657 with a cost of $753 and $486 at September 30, 2014 and December 31, 2013, respectively. These shares were withheld from employees to settle personal tax withholding obligations that arose as a result of restricted stock units that vested during 2014 and 2013.

Note I: 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 the nil coupon non-redeemable convertible unsecured loan notes, RSUs, and unexercised in-the-money stock options, except in periods of net loss where the effect of these instruments is anti-dilutive. Out-of-money stock options are excluded from diluted earnings per share because they are anti-dilutive. For the nine- months ended September 30, 2014, basic earnings per share is equal to diluted earnings per share because all outstanding stock awards and convertible loan notes are considered anti-dilutive during periods of net loss. The following table sets forth the weighted-average shares used in calculating the earnings per share for the three and nine- month periods ended September 30, 2014 and 2013.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Basic weighted-average shares	22,835,000	22,376,000	22,764,000	22,229,000
Conversion of unsecured loan notes	7,000	7,000	—	7,000
Unexercised options and unvested RSUs	374,000	151,000	—	222,000
Diluted weighted-average shares	23,216,000	22,534,000	22,764,000	22,458,000

Fuel Tech had 1,661,000 and 2,031,000 weighted average equity awards outstanding at September 30, 2014 and 2013, respectively, that were not dilutive for the purposes of inclusion in the calculation of diluted earnings per share but could potentially become dilutive in future periods.

Note J: Stock-Based Compensation

Fuel Tech's 2014 Long-term Incentive Plan (2014 Plan) was adopted in May 2014, and replaced our prior incentive plan which was first approved by our stockholders in 1993 and subsequently amended and approved by our stockholders in 2004 (FTIP). No further grants will be made from the FTIP. The 2014 Plan and FTIP are referred to collectively as the Incentive Plans.

The 2014 Plan permits grants of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards (in the form of equity or cash bonuses), dividend equivalents on full value awards and other awards (which may be based in whole or in part on the value of our common stock or other property). Directors, salaried employees, and consultants of Fuel Tech and its commonly-controlled affiliates are eligible to participate in the 2014 Plan. The number of shares originally reserved for share-based awards under the 2014 Plan equaled 2,000,000 shares, less the number of share-based awards made under the FTIP between December 31, 2013 and the effective date of the 2014 Plan. As of September 30, 2014, Fuel Tech had 1,437,150 shares available for share-based awards under the 2014 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 and nine- month periods ended September 30, 2014 and 2013 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Stock options and restricted stock units	$469	$542	$1,694	$1,207
Tax benefit of stock-based compensation expense	(180)	(203)	(652)	(450)
After-tax effect of stock-based compensation	$289	$339	$1,042	$757

As of September 30, 2014, there was $3,243 of total unrecognized compensation cost related to all non-vested share-based compensation arrangements granted under the Incentive Plans.

Stock Options

Stock options granted to employees under the Incentive Plans 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.

Based on the results of the model, the weighted-average fair value of the stock options granted during the nine-month period ended September 30, 2014 was $2.20 per option using the following assumptions:

Expected dividend yield	0.0%
Risk-free interest rate	1.55%
Expected volatility	47.4%
Expected life of option	4.9 years

Stock option activity for Fuel Tech's Incentive Plans for the nine- months ended September 30, 2014 was as follows:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding on January 1, 2014	1,688,500	$11.88		
Granted	94,500	5.22		
Exercised	(60,000)	4.96		
Expired or forfeited	(5,000)	22.63		
Outstanding on September 30, 2014	1,718,000	$11.73	3.46	$71
Exercisable on September 30, 2014	1,718,000	$11.73	3.46	$71

Non-vested stock option activity for the nine months ended September 30, 2014 was as follows:

	Non-Vested Stock Options Outstanding	Weighted-Average Grant Date Fair Value
Outstanding on January 1, 2014	10,000	$ 3.58
Granted	94,500	2.20
Vested	(104,500)	2.33
Forfeited	—	—
Outstanding on September 30, 2014	—	$ —

As of September 30, 2014, there was $0 of total unrecognized compensation cost related to non-vested stock options granted under the Incentive Plans.

Restricted Stock Units

Restricted stock units (RSUs) granted to employees vest over time based on continued service (typically vesting over a three year period in equal installments). Such time-vested RSUs are valued at fair value based on the closing price on the date of grant. 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, commencing in 2011, on an annual basis the Company entered into performance-based RSU agreements (the Agreements) with each of the Company's President/Chief Executive Officer, Treasurer/Chief Financial Officer, Executive Vice President of Marketing & Sales, and Executive Vice President and Chief Operating Officer. Commencing in 2013, the Company's Senior Vice President, General Counsel, and Secretary also entered into an agreement. The Agreements provide each participating executive the opportunity to earn 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 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 respective 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 trading price of the Company's stock 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 a period of two 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 trading price of the Company’s stock on the date of determination 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 a period of two 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. The principal variable assumptions utilized in valuing these RSUs under this valuation methodology include the risk-free interest rate, stock volatility, and correlations between our stock price and the stock prices of a peer group of companies.

At September 30, 2014, there is $3,243 of unrecognized compensation costs related to restricted stock unit awards to be recognized over a weighted average period of 1.95 years.

A summary of restricted stock unit activity for the nine-month period ended September 30, 2014 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested restricted stock units at January 1, 2014	772,016	$ 5.35
Granted	484,450	5.43
Forfeited	(14,515)	5.16
Vested	(230,507)	5.68
Unvested restricted stock units at September 30, 2014	1,011,444	$ 5.31

Deferred Directors Fees

In addition to the Incentive Plans, Fuel Tech has a Deferred Compensation Plans 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. In the nine-month periods ended September 30, 2014 and 2013, Fuel Tech recorded no stock-based compensation expense under the Deferred Plan.

Note K: Debt

On June 30, 2013, Fuel Tech amended its existing revolving credit facility (the Facility) with JPMorgan Chase Bank, N.A (JPM Chase) to extend the maturity date through June 30, 2015. The total borrowing base of the facility is $15,000 and contains a provision to increase the facility up to a total principal amount of $25,000 upon approval from JPM Chase. The Facility is unsecured, bears interest at a rate of LIBOR plus a spread range of 250 basis points to 375 basis points, as determined by a formula related to the Company’s leverage ratio, and has the Company’s Italian subsidiary, Fuel Tech S.r.l., as a guarantor. Fuel Tech can use this Facility for cash advances and standby letters of credit. As of September 30, 2014 and December 31, 2013, there were no outstanding borrowings on the credit facility. The Facility contains several debt covenants with which the Company must comply on a quarterly or annual basis, including 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. 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, depreciation and amortization, and stock-based compensation expenses. In addition, the Facility covenants include an annual capital expenditure limit of $10,000 and a minimum tangible net worth of $50,000. At

September 30, 2014, the Company was in compliance with all financial covenants specified by the Facility.

At September 30, 2014 and December 31, 2013, the Company had outstanding standby letters of credit and bank guarantees totaling approximately $8,262 and $3,478, respectively, on its domestic credit facility 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 September 30, 2014 and December 31, 2013, there were no cash borrowings under the domestic revolving credit facility and approximately $6,738 and $11,522, 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.

On June 27, 2014, Beijing Fuel Tech Environmental Technologies Company, Ltd. (Beijing Fuel Tech), a wholly-owned subsidiary of Fuel Tech, entered into a new revolving credit facility (the China Facility) agreement with JPM Chase for RMB 35 million (approximately $5,686), which expires on June 26, 2015. This credit facility replaced the previous RMB 35 million facility that expired on June 27, 2014. The facility is unsecured, bears interest at a rate of 125% of the People's Bank of China (PBOC) Base Rate, and is guaranteed by Fuel Tech. Beijing Fuel Tech can use this facility for cash advances and bank guarantees. As of September 30, 2014 and December 31, 2013, Beijing Fuel Tech has borrowings outstanding in the amount of $1,624 and $1,636, respectively. These borrowings were subject to interest rates of approximately 7.0% at September 30, 2014 and December 31, 2013, respectively.

At September 30, 2014 and December 31, 2013, the Company had outstanding standby letters of credit and bank guarantees totaling approximately $427 and $646, respectively, on its Beijing Fuel Tech revolving credit facility in connection with contracts in process. At September 30, 2014 and December 31, 2013, approximately $3,635 and $3,443 was available for future borrowings.

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 $96 and $29 were made during the nine-month periods ended September 30, 2014 and 2013.

Note L: 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 NOxOUT 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. Also included in this technology segment are Electrostatic Precipitator (ESP) rebuilds and retrofits and Flue Gas Conditioning systems, which are chemical injection systems used to enhance ESP 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 September 30, 2014	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Revenues from external customers	$ 11,140	$10,342	$—	$21,482
Cost of sales	(6,621)	(4,961)	—	(11,582)
Gross margin	4,519	5,381	—	9,900
Selling, general and administrative	—	—	(8,080)	(8,080)
Research and development	—	—	(379)	(379)
Operating income (loss)	$ 4,519	$5,381	$(8,459)	$1,441

Three months ended September 30, 2013	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Revenues from external customers	$ 23,420	$10,135	$—	$33,555
Cost of sales	(13,718)	(4,737)	—	(18,455)
Gross margin	9,702	5,398	—	15,100
Selling, general and administrative	—	—	(9,304)	(9,304)
Research and development	—	—	(461)	(461)
Operating income (loss)	$ 9,702	$5,398	$(9,765)	$5,335

Nine months ended September 30, 2014	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Revenues from external customers	$ 33,178	$27,155	$—	$60,333
Cost of sales	(21,339)	(12,730)	—	(34,069)
Gross margin	11,839	14,425	—	26,264
Selling, general and administrative	—	—	(25,783)	(25,783)
Research and development	—	—	(848)	(848)
Operating income (loss)	$ 11,839	$14,425	$(26,631)	$(367)

Nine months ended September 30, 2013	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Revenues from external customers	$ 56,606	$28,525	$—	$85,131
Cost of sales	(35,384)	(13,350)	—	(48,734)
Gross margin	21,222	15,175	—	36,397
Selling, general and administrative	—	—	(27,069)	(27,069)
Research and development	—	—	(1,824)	(1,824)
Operating income (loss)	$ 21,222	$15,175	$(28,893)	$7,504

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 September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues:				
United States	$10,690	$20,685	$33,653	$50,795
Foreign	10,792	12,870	26,680	34,336
	$21,482	$33,555	$60,333	$85,131
			September 30, 2014	December 31, 2013
Assets:				
United States			$81,958	$83,464
Foreign			27,984	26,594
			$109,942	$110,058

Note M: 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 nine months September 30, 2014, and 2013, are summarized below:

	Nine Months Ended September 30,	
	2014	2013
Aggregate product warranty liability at beginning of period	$596	$776
Net aggregate (benefit) expense related to product warranties	(147)	208
Aggregate reductions for payments	(17)	(89)
Aggregate product warranty liability at end of period	$432	$895

Note N: Income Taxes

The Company's effective tax rate of 23% and 35% for the nine-month periods ended September 30, 2014 and 2013, respectively, differs from the statutory federal tax rate of 34% due primarily to state taxes, differences between U.S. and foreign tax rates, foreign losses incurred with no related tax benefit, non-deductible commissions, and non-deductible meals and entertainment expenses.

Fuel Tech had unrecognized tax benefits as of September 30, 2014 and December 31, 2013 in the amount of $117, respectively, all of which, if ultimately recognized, will reduce Fuel Tech's annual effective tax rate.

Note O: Goodwill and Other Intangibles

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 September 30, 2014 and December 31, 2013, goodwill allocated to the FUEL CHEM technology segment was $1,723 and $1,723, respectively, while goodwill allocated to the APC technology segment was $24,416 and $19,328, respectively. The $5,088 increase in goodwill in the APC technology segment is due to the acquisitions of Cleveland Roll Forming Environmental Division, Inc. d/b/a PECO ("PECO"), and FGC, Inc. ("FGC") on April 30, 2014. Both of these acquisitions were accounted for under the acquisition method of accounting, which requires Fuel Tech to perform an allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition. The excess of the purchase price over the estimated fair values is recorded as goodwill. The increase in goodwill reflected above is a preliminary estimate as the fair value of assessments have not been finalized. Any changes to the estimated fair values of the assets acquired and liabilities assumed may change the amount of the purchase price allocable to goodwill. Fuel Tech expects to finalize the purchase price allocation by the end of the current fiscal year. Refer to Note R to the consolidated financial statements for additional details.

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 annual fair value measurement test, performed as of October 1, 2013 revealed no indications of impairment. There were no indications of goodwill impairment in the nine-month periods ended September 30, 2014 and 2013.

At September 30, 2014 and December 31, 2013, net other intangible assets were $10,616 and $4,305, respectively. The April 30, 2014 acquisitions of PECO and FGC resulted in additional other intangibles of $4,126 based on a preliminary assessment of the fair value of the intangibles acquired. Refer to Note R for additional details regarding the allocation of the purchase price for these two business acquisitions. In addition, on September 18, 2014, Fuel Tech purchased intellectual property rights and know-how associated with the CARBONITE® fuel conversion process in the amount of $3,010, which was accounted for as a purchase of identifiable intangible assets.

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 nine-month periods ended September 30, 2014 and 2013.

Note P: Fair Value

The Company applies authoritative accounting guidance for fair value measurements of financial and nonfinancial assets and liabilities. This guidance defines fair value, establishes a consistent framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis and clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the standard establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 – Observable inputs to the valuation methodology such as quoted prices in active markets for identical assets or liabilities
- Level 2 – Inputs to the valuation methodology including quoted prices for similar assets or liabilities in active markets, quoted prices for identical assets of liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived principally from or corroborated by observable market data by correlation or other means
- Level 3 – Significant unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own estimates and assumptions or those expected to be used by market participants. Generally, these fair value measures are model-based valuation techniques such as discounted cash flows, option pricing models, and other commonly used valuation techniques

The fair value of our marketable securities was $35 and $30 at September 30, 2014 and December 31, 2013, respectively, and was determined using quoted prices in active markets for identical assets (Level 1 fair value measurements). Transfers between levels of the fair value hierarchy are recognized based on the actual date of the event or change in circumstances that caused the transfer. We had no assets or liabilities that were valued using level 2 or level 3 inputs and therefore there were no transfers between levels of the fair value hierarchy during the nine-month periods ended September 30, 2014 and 2013.

The carrying amount of our short-term debt and revolving line of credit approximates fair value due to its short-term nature and because the amounts outstanding accrue interest at variable market-based rates.

Note Q: Recently Added and Pending Accounting Pronouncements

On January 1, 2014, Fuel Tech adopted changes issued by the Financial Accounting Standards Board (FASB) to the accounting for obligations resulting from joint and several liability arrangements. These changes require an entity to measure such obligations for which the total amount of the obligation is fixed at the reporting date as the sum of (i) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors, and (ii) any additional amount the reporting entity expects to pay on behalf of its co-obligors. An entity will also be required to disclose the nature and amount of the obligation as well as other information about those obligations. Examples of obligations subject to these requirements are debt arrangements and settled litigation and judicial rulings. The adoption of these changes had no impact on the Consolidated Financial Statements, as Fuel Tech does not currently have any such arrangements.

On January 1, 2014, Fuel Tech adopted changes issued by the FASB to a parent entity's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries or groups of assets within a foreign entity or of an investment in a foreign entity. A parent entity is required to release any related cumulative foreign currency translation adjustment from accumulated other comprehensive income into net income in the following circumstances: (i) a parent entity ceases to have a controlling financial interest in a subsidiary or group of assets that is a business within a foreign entity if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided; (ii) a partial sale of an equity method investment that is a foreign entity; (iii) a partial sale of an equity method investment that is not a foreign entity whereby the partial sale represents a complete or substantially complete liquidation of the foreign entity that held the equity method investment; and (iv) the sale of an investment in a foreign entity. The adoption of these changes had no impact on the Consolidated Financial Statements. This guidance will need to be considered in the event Fuel Tech initiates any of the transactions described above.

On January 1, 2014, Fuel Tech adopted changes issued by the FASB to the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. These changes require an entity to present an unrecognized tax benefit as a liability in the financial statements if (i) a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, or (ii) the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset to settle any additional income taxes that would result from the disallowance of a tax position. Otherwise, an unrecognized tax benefit is required to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. Previously, there was diversity in practice as no explicit guidance existed. The adoption of these changes did not result in a significant impact on the Consolidated Financial Statements.

In April 2014, the FASB issued changes to reporting discontinued operations and disclosures of disposals of components of an entity. These changes require a disposal of a component to meet a higher threshold in order to be reported as a discontinued operation in an entity's financial statements. The threshold is defined as a strategic shift that has, or will have, a major effect on an entity's operations and financial results such as a disposal of a major geographical area or a major line of business. Additionally, the following two criteria have been removed from consideration of whether a component meets the requirements for discontinued operations presentation: (i) the operations and cash flows of a disposal component have been or will be eliminated from the ongoing operations of an entity as a result of the disposal transaction, and (ii) an entity will not have any significant continuing involvement in the operations of the disposal component after the disposal transaction. Furthermore, equity method investments now may qualify for discontinued operations presentation. These changes also require expanded disclosures for all disposals of components of an entity, whether or not the threshold for reporting as a discontinued operation is met, related to profit or loss information and/or asset and liability information of the component. These changes become effective for Fuel Tech on January 1, 2015. Management has determined that the adoption of these changes will not have an immediate impact on the Consolidated Financial Statements. This guidance will need to be considered in the event Fuel Tech initiates a disposal transaction.

In May 2014, the FASB issued changes to the recognition of revenue from contracts with customers. These changes created a comprehensive framework for all entities in all industries to apply in the determination of when to recognize revenue, and, therefore, supersede virtually all existing revenue recognition requirements and guidance. This framework is expected to result in less complex guidance in application while providing a consistent and comparable methodology for revenue recognition. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract(s), (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract(s), and (v) recognize revenue when, or as, the entity satisfies a performance obligation. These changes become effective for Fuel Tech on January 1, 2017. Management is currently evaluating the potential impact of these changes on the Consolidated Financial Statements.

In August 2014, the FASB issued changes to the disclosure of uncertainties about an entity's ability to continue as a going concern. Under GAAP, continuation of a reporting entity as a going concern is presumed as the basis for preparing financial statements unless and until the entity's liquidation becomes imminent. Even if an entity's liquidation is not imminent, there may be conditions or events that raise substantial doubt about the entity's ability to continue as a going concern. Because there is no guidance in GAAP about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern or to provide related note disclosures, there is diversity in practice whether, when, and how an entity discloses the relevant conditions and events in its financial statements. As a result, these changes require an entity's management to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue

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as a going concern within one year after the date that financial statements are issued. Substantial doubt is defined as an indication that it is probable that an entity will be unable to meet its obligations as they become due within one year after the date that financial statements are issued. If management has concluded that substantial doubt exists, then the following disclosures should be made in the financial statements: (i) principal conditions or events that raised the substantial doubt, (ii) management’s evaluation of the significance of those conditions or events in relation to the entity’s ability to meet its obligations, (iii) management’s plans that alleviated the initial substantial doubt or, if substantial doubt was not alleviated, management’s plans that are intended to at least mitigate the conditions or events that raise substantial doubt, and (iv) if the latter in (iii) is disclosed, an explicit statement that there is substantial doubt about the entity’s ability to continue as a going concern. These changes become effective for Fuel Tech for the 2016 annual period. Management has determined that the adoption of these changes will not have an impact on the Consolidated Financial Statements. Subsequent to adoption, this guidance will need to be applied by management at the end of each annual period and interim period therein to determine what, if any, impact there will be on the Consolidated Financial Statements in a given reporting period.

Note R: Business Acquisitions

On April 30, 2014 Fuel Tech acquired 100% of the capital stock of Cleveland Roll Forming Environmental Division, Inc. d/b/a PECO (“PECO”), and FGC, Inc. ("FGC"), both Ohio corporations. Pursuant to the stock purchase agreements, PECO and FGC became wholly owned subsidiaries of Fuel Tech. Fuel Tech paid to the sellers total net cash consideration of $8,079, which consists of the agreed upon purchase price of $8,250 plus a working capital adjustment of $391, less cash acquired of $562. The stock purchase agreements contains customary representations, warranties and indemnities.

PECO specializes in electrostatic precipitator (ESP) rebuilds, retrofits and associated products and services. FGC specializes in flue gas conditioning to enhance electrostatic precipitator and fabric filter performance in boilers. These acquisitions broaden our APC product portfolio and grants us immediate access into the fast-growing particulate control market, creating opportunities both domestically and abroad.

The PECO and FGC acquisitions is being accounted for using the acquisition method of accounting whereby the total purchase price is allocated to tangible and intangible assets and liabilities based on their estimated fair market values on the date of acquisition. These fair value estimates will be based on a third party valuation that is expected to be finalized in the fourth quarter of 2014.
The fair value of identifiable intangible assets was measured based upon significant inputs that were not observable in the market, and therefore are classified as Level 3. The key assumptions include: (i) management's projection of future cash flows based upon past experience and future expectations, and (ii) an assumed discount rate of 18.5% for PECO and 33.5% for FGC.
The following table summarizes the approximate fair values of the assets acquired and liabilities assumed at the date of acquisition and incorporates the provisional adjustments in our measurements since they were original reported in our Form 10-Q for the period ended June 30, 2014. The approximate fair value of the assets and liabilities assumed, and the related tax balances, are based on preliminary estimates and assumptions. These preliminary estimates and assumptions could change significantly during the purchase price measurement period as we finalize the valuations of these assets and liabilities. Such changes could result in material variances between the Company's future financial results and the amounts presented in the unaudited pro-forma information, including variances in estimated purchase price, fair values recorded, and expenses associated with these items.

	As Reported on June 30, 2014	Provisional Adjustments	Estimated Fair Values September 30, 2014

Current assets	$2,365	$92	$2,457
Property, plant and equipment	281	(281)	—
Identifiable intangible assets	—	4,126	4,126
Current and long-term liabilities assumed	(2,035)	(1,557)	(3,592)
Total identifiable net assets acquired	611	2,380	2,991
Goodwill	7,468	(2,380)	5,088
Total assets acquired	$8,079	$—	$8,079

The goodwill recorded in connection with the above acquisition is primarily attributable to the strong cash flow expected from the acquisitions as a result of the synergies with our APC technology segment expected to arise after the Company's acquisition of the businesses. The goodwill and identifiable intangibles are not deductible for tax purposes.

The preliminary fair value assigned to finite lived intangible assets as a result of the acquisitions was as follows:

Description	Amount	Useful Life (Yrs)
Order backlog	$470	1.0
Trademarks	90	2.0
Customer relationships	540	4.0
Developed technology	3,230	7.0
Revenue in excess of billings	283	0.5
Assumed deferred revenue obligation	(487)	1.0
Total identifiable assets acquired	$4,126	6.1

The following table summarizes the net sales and earnings after income taxes of PECO and FGC since the acquisition date, April 30, 2014, which is included in the consolidated statements of operations for the three and nine months ended September 30, 2014:

	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Revenue	$1,052	$3,493
Net income before taxes	243	837
Net income before taxes per Common Share		
Basic	$0.01	$0.04
Diluted	$0.01	$0.04

The following unaudited pro-forma information represents the Company's results of operations as if the acquisition date had occurred on January 1, 2013:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenue	$21,482	$34,727	$66,030	$91,826
Net income / (loss)	712	3,961	194	5,429
Net income / (loss) per Common Share				
Basic	$0.03	$0.18	$0.01	$0.24
Diluted	$0.03	$0.18	$0.01	$0.24

The pro-forma results have been prepared for informational purposes only and include adjustments to eliminate acquisition related expenses, inter-company transactions, amortization of acquired intangible assets with finite lives, and to record the income tax consequences of the pro-forma adjustments. These pro-forma results do not purport to be indicative of the results of operations that would have occurred had the purchases been made as of the beginning of the periods presented or of the results of operations that may occur in the future.

Transaction costs incurred for the acquisition date were $59, of which $48 was recognized during the three months ended June 30, 2014, and are included included in general and administrative expenses in the Consolidated Statement of Operations for the three and nine months ended September 30, 2014.

FUEL TECH, INC.

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

Results of Operations

Revenues for the three- and nine-months ended September 30, 2014 and 2013 were $21,482 and $33,555, and $60,333 and $85,131, respectively, representing a 36% and 29% respective decrease versus the same periods last year.

The Air Pollution Control (APC) technology segment generated revenues of $11,140 and $33,178 for the three- and nine-month periods ending September 30, 2014, respectively, a decrease of $12,280 or 52%, and $23,428 or 41% from the prior period amounts of $23,420 and $56,606, respectively.

Consolidated APC backlog at September 30, 2014 was $19,557 versus backlog at September 30, 2013 of $33,389. Our current backlog consists of US domestic projects totaling $12,788 and international projects totaling $6,769.

The FUEL CHEM® technology segment generated revenues of $10,342 and $27,155 for the three- and nine-months ended September 30, 2014, respectively. For the three-month period this represents a modest increase of $207 versus the prior year amount of $10,135. For the nine-month period ended September 30, 2014 this represents a decrease of $1,370 or 5% compared to the prior year period amount of $28,525 . This segment continues to be affected by the soft electric demand market and low natural gas prices, which leads to fuel switching, unscheduled outages, and combustion units operating at less than capacity.

Consolidated gross margin percentage for both the three- and nine month periods ended September 30, 2014 and 2013 was 46% and 44%, and 45% and 43%, respectively. The gross margin percentage for the APC technology segment as compared to the prior year quarter remained flat at 41%. For the FUEL CHEM technology segment, the gross margin percentage decreased slightly to 52% from 53% in the comparable prior-year quarter. For the nine-month period, the gross margin percentage for the APC technology segment decreased to 36% from 38% compared to the prior-year period, and for the FUEL CHEM technology segment the gross margin percentage remained flat at 53% as compared to the prior-year period.

Selling, general and administrative expenses (SG&A) for the three- and nine-month periods ended September 30, 2014 were $8,080 and $25,783, respectively, and for the same periods in 2013 were $9,304 and $27,069, respectively. For the three-month period ended September 30, 2014 this represents a decrease of $1,224, which was primarily the result of decreases in employee related costs of $851, administrative costs associated with our foreign operations of $556, and bad debt expense of $323, partially offset by increases in consulting and outside services of $186, professional fees of $163 and depreciation of $82. SG&A for the nine month period ended September 30, 2014 decreased by $1,286, which was primarily the result of decreases in employee related costs of $2,163, administrative costs associated with our foreign operations of $507, and bad debt expense of $289, partially offset by increases in stock compensation of $488, consulting and outside services of $183, professional fees of $427, former leased office expenses of $300, and depreciation of $229. SG&A as a percentage of revenues increased to 38% from 28% in the three-month periods, and increased to 43% from 32% in the nine-month periods ending September 30, 2014 and 2013, respectively. These increases in SG&A percentages are attributed to lower revenues in the current periods compared to the prior periods.

Research and development expenses for the three and nine-month periods ended September 30, 2014 and 2013 were $379 and $461, and $848 and $1,824, respectively. Although our annual R&D spending has decreased, the Company plans to continue to pursue new commercial applications for technologies outside of our traditional markets and in the development and analysis of new technologies that could represent incremental market opportunities.

Interest expense for the three- and nine-month periods ended September 30, 2014 and 2013 were $33 and $19, and $96 and $29, respectively. This interest expense relates to borrowings made under the Beijing Fuel Tech credit facility.

Income tax benefit (expense) for the three- and nine-months ended ended September 30, 2014 and 2013 were $63 and $(1,768), and $180 and $(2,532) respectively. The Company is projecting a consolidated effective tax rate of 20% for 2014 which is lower than the federal income tax rate of 34% due to the effect of income tax credits and other permanent items including losses in foreign jurisdictions for which we will receive no tax benefit.

Liquidity and Sources of Capital

At September 30, 2014, Fuel Tech had cash and cash equivalents and short-term investments on hand of $15,578 and working capital of $39,446 versus $27,768 and $48,619 at December 31, 2013, respectively.

Operating activities provided cash of $1,403 during the nine-month period ended September 30, 2014. This increase in cash from operations was due to a decrease in accounts receivable of $4,291 and non-cash expenses of $3,813, offset by cash used as a result of our net loss of $614, an increase in inventories and prepaid expenses of $1,491 and a decrease in the outstanding accounts payable and accrued liabilities balances of $4,596.

Investing activities used cash of $13,230 during the nine-month period ended September 30, 2014 and related to net cash used for the PECO and FGC acquisitions of $8,079, purchases of equipment and patents of $2,141, and a purchase of other intangible assets related to the Carbonite® fuel conversion process of $3,010.

Financing activities provided cash of $37 as a result of exercise proceeds and excess tax benefits from the exercise of stock options of $304 , offset by cash used of $267 for the acquisition of common shares held in treasury that were withheld for taxes due by employees upon lapsing of restricted stock units.

On June 30, 2013, Fuel Tech amended its existing revolving credit facility (the Facility) with JPMorgan Chase Bank, N.A (JPM Chase) to extend the maturity date through June 30, 2015. The total borrowing base of the facility is $15,000 and contains a provision to increase the facility up to a total principal amount of $25,000 upon approval from JPM Chase. The Facility is unsecured, bears interest at a rate of LIBOR plus a spread range of 250 basis points to 375 basis points, as determined by a formula related to the Company’s leverage ratio, and has the Company’s Italian subsidiary, Fuel Tech S.r.l., as a guarantor. Fuel Tech can use this Facility for cash advances and standby letters of credit. As of September 30, 2014 and December 31, 2013, there were no outstanding borrowings on the credit facility. The Facility contains several debt covenants with which the Company must comply on a quarterly or annual basis, including 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. 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, depreciation and amortization, and stock-based compensation expenses. In addition, the Facility covenants include an annual capital expenditure limit of $10,000 and a minimum tangible net worth of $50,000. At September 30, 2014, the Company was in compliance with all financial covenants specified by the Facility.
At September 30, 2014 and December 31, 2013, the Company had outstanding standby letters of credit and bank guarantees totaling approximately $8,262 and $3,478, respectively, on its domestic credit facility 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 September 30, 2014 and December 31, 2013, there were no cash borrowings under the domestic revolving credit facility and approximately $6,738 and $11,522, 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.
On June 27, 2014, Beijing Fuel Tech Environmental Technologies Company, Ltd. (Beijing Fuel Tech), a wholly-owned subsidiary of Fuel Tech, entered into a new revolving credit facility (the China Facility) agreement with JPM Chase for RMB 35 million (approximately $5,686), which expires on June 26, 2015. This credit facility replaced the previous RMB 35 million facility that expired on June 27, 2014. The facility is unsecured, bears interest at a rate of 125% of the People’s Bank of China (PBOC) Base Rate, and is guaranteed by Fuel Tech. Beijing Fuel Tech can use this facility for cash advances and bank guarantees. As of September 30, 2014 and December 31, 2013, Beijing Fuel Tech has borrowings outstanding in the amount of $1,624 and $1,636, respectively. These borrowings were subject to interest rates of approximately 7.0% at September 30, 2014 and December 31, 2013, respectively.
At September 30, 2014 and December 31, 2013, the Company had outstanding standby letters of credit and bank guarantees totaling approximately $427 and $646, respectively, on its Beijing Fuel Tech revolving credit facility in connection with contracts in process. At September 30, 2014 and December 31, 2013, approximately $3,635 and $3,443 was available for future borrowings.
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.

Contingencies and Contractual Obligations

Fuel Tech issues a standard product warranty with the sale of its products to customers as discussed in Note M. The warranty liability balance during the nine-months ended September 30, 2014 decreased by approximately $164.

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 these w 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, 2013 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 debt facilities (refer to Note K 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, 2014.

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 were changes as described below in Fuel Tech's internal control over financial reporting during the quarter to which this report relates that have materially affected, or are reasonably likely to materially affect Fuel Tech's internal control over financial reporting.

During the first quarter of 2014, Fuel Tech implemented a series of Epicor ERP modules, including a new general ledger and chart of accounts, new reporting and accounts payable and new procurement and materials management modules. The introduction of these ERP modules and the related workflow capabilities resulted in changes to Fuel Tech's financial reporting controls and procedures, with such changes identified during the implementation of the ERP modules. Therefore, as appropriate, Fuel Tech is modifying the design and documentation of internal control process and procedures relating to the new system to supplement and complement existing internal controls over financial reporting. The system changes were undertaken to integrate systems and consolidate information, and were not undertaken in response to any actual or perceived deficiencies in Fuel Tech's control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are from time to time involved in litigation incidental to our business. We are not currently involved in any litigation in which we believe an adverse outcome would have a material effect on our business, financial conditions, results of operations, or prospects.

Item 1A. Risk Factors

The risk factors included in our Annual Report on Form 10-K for fiscal year ended December 31, 2013 have not materially changed.

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

None

Item 6. Exhibits

a. Exhibits (all filed herewith)

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
101.1	INSXBRL Instance Document
101.2	SCHXBRL Taxonomy Extension Schema Document
101.3	CALXBRL Taxonomy Extension Calculation Linkbase Document
101.4	DEFXBRL Taxonomy Extension Definition Linkbase Document
101.5	LABXBRL Taxonomy Extension Label Linkbase Document
101.6	PREXBRL Taxonomy Extension Prevention Linkbase Document

FUEL TECH, INC.
Signatures
Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 6, 2014	By: /s/ Douglas G. Bailey Douglas G. Bailey President and Chief Executive Officer (Principal Executive Officer)
Date: November 6, 2014	By: /s/ David S. Collins David S. Collins Senior Vice President and Chief Financial Officer (Principal Financial Officer)