

FUEL TECH, INC.
Form 10-Q
August 14, 2017

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

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

For the quarterly period ended June 30, 2017

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 ☒ 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 ☒ 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 ☐

Non-accelerated filer ☐ Smaller reporting company ☒

(Do not check if a smaller reporting company) Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act ☐

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

On July 31, 2017 there were outstanding 24,132,910 shares of Common Stock, par value \$0.01 per share, of the registrant.

FUEL TECH, INC.
Form 10-Q for the six-month period ended June 30, 2017
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

FUEL TECH, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(in thousands, except share and per share data)

	June 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$6,576	\$ 11,826
Restricted cash	1,020	6,020
Marketable securities	11	9
Accounts receivable, net of allowance for doubtful accounts of \$1,610 and \$1,569, respectively	18,969	18,790
Inventories, net	1,560	1,012
Prepaid expenses and other current assets	2,984	2,891
Income taxes receivable	65	87
Total current assets	31,185	40,635
Property and equipment, net of accumulated depreciation of \$25,334 and \$24,542, respectively	6,601	10,517
Goodwill	2,116	2,116
Other intangible assets, net of accumulated amortization of \$6,313 and \$5,902, respectively	1,722	1,796
Restricted cash	5,000	—
Assets held for sale	1,839	2,058
Other assets	595	666
Total assets	\$49,058	\$ 57,788
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	4,737	6,303
Accrued liabilities:		
Employee compensation	1,189	1,390
Other accrued liabilities	7,192	6,357
Total current liabilities	13,118	14,050
Other liabilities	512	346
Total liabilities	13,630	14,396
COMMITMENTS AND CONTINGENCIES (Note 10)		
Shareholders' equity:		
Common stock, \$.01 par value, 40,000,000 shares authorized, 24,777,001 and 23,800,924 shares issued, and 24,132,910, and 23,446,035 shares outstanding, respectively	248	238
Additional paid-in capital	138,527	137,380
Accumulated deficit	(100,880)	(91,520)
Accumulated other comprehensive loss	(1,071)	(1,568)
Nil coupon perpetual loan notes	76	76

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Treasury stock, at cost	(1,472)	(1,214)
Total shareholders' equity	35,428	43,392
Total liabilities and shareholders' equity	\$49,058	\$ 57,788
See notes to condensed consolidated financial statements.		

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenues	\$9,741	\$ 15,175	\$18,232	\$ 32,997
Costs and expenses:				
Cost of sales	6,116	9,595	10,885	21,369
Selling, general and administrative	5,923	6,760	11,077	13,922
Restructuring charge	58	—	119	317
Research and development	280	295	564	766
Building impairment	2,965	—	2,965	—
	15,342	16,650	25,610	36,374
Operating loss	(5,601)	(1,475)	(7,378)	(3,377)
Interest income	3	6	6	16
Other expense	(2)	(221)	(4)	(484)
Loss from continuing operations before income taxes	(5,600)	(1,690)	(7,376)	(3,845)
Income tax benefit (expense)	15	(111)	15	94
Net loss from continuing operations	(5,585)	(1,801)	(7,361)	(3,751)
Loss from discontinued operations (net of income tax benefit of \$0 in 2017 and 2016)	(1,269)	(827)	(1,999)	(1,514)
Net loss	\$(6,854)	\$(2,628)	\$(9,360)	\$(5,265)
Net loss per common share:				
Basic				
Continuing operations	\$(0.24)	\$(0.08)	\$(0.31)	\$(0.16)
Discontinued operations	\$(0.05)	\$(0.04)	\$(0.08)	\$(0.07)
Basic net loss per common share	\$(0.29)	\$(0.12)	\$(0.39)	\$(0.23)
Diluted				
Continuing operations	\$(0.24)	\$(0.08)	\$(0.31)	\$(0.16)
Discontinued operations	\$(0.05)	\$(0.04)	\$(0.08)	\$(0.07)
Diluted net loss per common share	\$(0.29)	\$(0.12)	\$(0.39)	\$(0.23)
Weighted-average number of common shares outstanding:				
Basic	23,738,000	23,381,000	23,606,000	23,283,000
Diluted	23,738,000	23,381,000	23,606,000	23,283,000
See notes to condensed consolidated financial statements.				

FUEL TECH, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

(in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net loss	\$ (6,854)	\$ (2,628)	\$ (9,360)	\$ (5,265)
Other comprehensive income (loss):				
Foreign currency translation adjustments	380	(111)	496	318
Unrealized gains (losses) from marketable securities, net of tax	—	(5)	1	(8)
Total other comprehensive income (loss)	380	(116)	497	310
Comprehensive loss	\$ (6,474)	\$ (2,744)	\$ (8,863)	\$ (4,955)
See notes to condensed consolidated financial statements.				

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

	Six Months Ended June 30,	
	2017	2016
Operating Activities		
Net loss	\$(9,360)	\$(5,265)
Loss from discontinued operations	1,999	1,514
Net loss from continuing operations	(7,361)	(3,751)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	755	926
Amortization	109	560
Loss on disposal of equipment	114	26
Provision for doubtful accounts, net of recoveries	30	151
Excess and obsolete inventory reserve	228	—
Deferred income taxes	—	(10)
Building impairment	2,965	—
Stock-based compensation, net of forfeitures	1,156	1,041
Changes in operating assets and liabilities:		
Accounts receivable	(110)	173
Inventories	(570)	149
Prepaid expenses, other current assets and other non-current assets	16	2,861
Accounts payable	(1,591)	(1,630)
Accrued liabilities and other non-current liabilities	323	(1,482)
Net cash used in operating activities - continuing operations	(3,936)	(986)
Net cash used in operating activities - discontinued operations	(1,316)	(1,213)
Net cash used in operating activities	(5,252)	(2,199)
Investing Activities		
Purchases of equipment and patents	(233)	(302)
Proceeds from the sale of equipment	1	1
Net cash used in investing activities	(232)	(301)
Financing Activities		
Change in restricted cash	—	(7,020)
Taxes paid on behalf of equity award participants	(258)	(172)
Net cash used in financing activities	(258)	(7,192)
Effect of exchange rate fluctuations on cash	492	434
Net decrease in cash and cash equivalents	(5,250)	(9,258)
Cash and cash equivalents at beginning of period	11,826	21,684
Cash and cash equivalents at end of period	\$6,576	\$12,426
See notes to condensed consolidated financial statements.		

FUEL TECH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017

(Unaudited)

(in thousands, except share and per-share data)

1. General

Organization

Fuel Tech, Inc. and subsidiaries ("Fuel Tech", the "Company", "we", "us" or "our") provides advanced engineered solutions for the optimization of combustion systems in utility and industrial applications. Our primary focus is on the worldwide marketing and sale of NOx reduction technologies as well as our FUEL CHEM program. The Company's NOx reduction technologies reduce nitrogen oxide emissions from boilers, furnaces and other stationary combustion sources.

Our FUEL CHEM program is based on proprietary TIFI® Targeted In-Furnace™ Injection technology, in combination with advanced Computational Fluid Dynamics (CFD) and Chemical Kinetics Modeling (CKM) boiler modeling, in the unique application of specialty chemicals to improve the efficiency, reliability and environmental status of combustion units by controlling slagging, fouling, corrosion, opacity and other sulfur trioxide-related issues in the boiler.

Our business is materially dependent on the continued existence and enforcement of air quality regulations, particularly in the United States. 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.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") 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 U.S. GAAP for complete financial statements. In the opinion of management, the financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the statements for the periods presented. All significant intercompany transactions and balances have been eliminated. The results of operations for the three and six months ended June 30, 2017 are not necessarily indicative of the results to be expected for the full year ending December 31, 2017. For further information, refer to the audited consolidated financial statements and footnotes thereto included in Fuel Tech's Annual Report on Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission.

Reclassifications

Certain reclassifications to prior year amounts have been made in the consolidated financial statements to conform to the current year presentation.

2. Summary of Significant Accounting Policies

Restricted cash

Restricted cash represents funds that are restricted to satisfy any amount borrowed against the Company's existing revolving credit facility (the Facility) with JPMorgan Chase Bank, N.A. The balance of restricted cash totaling \$6,020 will remain through the Maturity Date of the Facility. Refer to Note 9 Debt Financing for further information on the Facility.

Revenue Recognition

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 (APC) 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.

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 June 30, 2017 and December 31, 2016, unbilled receivables were approximately \$5,296 and \$6,755, respectively, and are included in accounts receivable on the consolidated balance sheets. Billings in excess of costs and estimated earnings on uncompleted contracts were \$2,374 and \$1,730, at June 30, 2017 and December 31, 2016, respectively, and are included in other accrued liabilities on the consolidated balance sheets. As of June 30, 2017, we had two construction contracts in progress that were identified as loss contracts and a provision for losses of \$262 was recorded in other accrued liabilities on the consolidated balance sheet.

Fuel Tech has installed over 1,000 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.

Building Impairment

During the second quarter of 2017, we experienced a decrease in our stock price that caused our market capitalization to fall below the equity value on our consolidated balance sheet, which resulted in an indicator of impairment. This, along with an overall slowdown in APC technology and corresponding downward adjustments to our financial forecasts, was considered during a detailed evaluation of the fair value of our reporting units. As a result of these triggering events, Fuel Tech performed a long-lived asset impairment analysis for each of the reporting units as of April 1, 2017. Based on this evaluation, we determined that our APC segment failed the first step of our impairment analysis because the estimated gross cash flows and fair value of the reporting unit was less than its carrying value, thus requiring additional analysis of the segment. However, no impairment resulted as the fair values of the underlying patents and equipment equaled or exceeded their carrying values. We evaluated the corporate asset group, which contains our corporate headquarters office building and land in Warrenville, Illinois, using the residual method and management determined that there was not adequate gross cash flows to support the carrying value. After obtaining an appraisal from a third-party appraiser, management determined that the carrying value of the office building and land exceeded the fair value and recorded an impairment charge of \$2,965 for the three- and six- months ended June 30, 2017.

Recently Adopted Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The amendments in this Update simplify the income tax effects, minimum statutory tax withholding requirements and impact of forfeitures related to how share-based payments are accounted for and presented in the financial statements. ASU 2016-09 is effective for the Company beginning on

January 1, 2017. The adoption of ASU 2016-09 did not have a material effect on our earnings, cash flows, or financial position. See Note 8, Stock-Based Compensation, for further discussion.

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. This new accounting guidance more clearly articulates the requirements for the measurement and disclosure of inventory. Topic 330, Inventory, currently requires an entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. This new accounting guidance requires the measurement of inventory at lower of cost and net realizable value. The adoption of ASU 2015-11 is effective for the Company beginning on January 1, 2017 and the adoption did not have a material impact on the Company's consolidated financial statements.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued ASU 2014-09 "Revenue from Contracts with Customers" (Topic 606). This new accounting guidance on revenue recognition provides for a single five-step model to be applied to all revenue contracts with customers. The new standard also requires additional financial statement disclosures that will enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows relating to customer contracts. In August 2015, the FASB approved a one-year deferral to January 1, 2018. Early adoption is permitted as of the original effective date. The standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company is in the initial stages of evaluating the impact of the new standard on the accounting policies, processes, and system requirements. While the Company continues to assess the potential impacts of the new standard and anticipate this standard could have a material impact on the consolidated financial statements, the Company does not know or cannot reasonably estimate quantitative information related to the impact of the new standard on the financial statements at this time.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The amendments in this Update increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 will be effective for the Company beginning on January 1, 2019. The Company is in the initial stages of evaluating the impact of the new standard on the accounting policies, processes, and system requirements. While the Company continues to assess the potential impacts of the new standard and anticipate this standard could have a material impact on the consolidated financial statements, the Company does not know or cannot reasonably estimate quantitative information related to the impact of the new standard on the financial statements at this time.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force). The amendments in this Update require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. ASU 2016-18 will be effective for the Company beginning on January 1, 2018. The Company is currently evaluating the impact of this new standard on its consolidated financial statements at this time.

In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The amendments in this Update simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. ASU 2017-04 will be effective for the Company beginning on January 1, 2020. The Company is in the initial stages of evaluating the impact of the new standard on the accounting policies, processes, and system requirements. While the Company continues to assess the potential impacts of the new standard and anticipate this standard could have a material impact on the consolidated financial statements, the Company does not know or cannot reasonably estimate quantitative information related to the impact of the new standard on the financial statements at this time.

3. Discontinued Operations

Effective June 28, 2017, the Company has suspended all operations associated with the Fuel Conversion business segment. The components of the net assets of the Fuel Conversion discontinued operations as of June 30, 2017 are Assets held for sale on the Consolidated Balance Sheets totaling \$1,839 which consists of certain equipment of \$485 and the Carbonite intangible asset of \$1,354. The resulting amount in Assets held for sale was determined using management's assumptions based on a plan of sale and may not be able to realize as much value from the sale of the assets as we expect. In addition, accrued severance of \$382 is included in the other accrued liabilities line of the Consolidated Balance Sheets. The Fuel Conversion business segment had no other assets or liabilities associated with

it.

The Condensed Statement of Operations of the Fuel Conversion discontinued operations consisted of Research and Development for the three- and six-month periods ended June 30, 2017 of \$1,269 and \$1,999, respectively, and for the same periods in 2016 of \$827 and \$1,514, respectively. Research and Development for the three- and six-month periods ended June 30, 2017 include the severance charges associated with suspension of the Fuel Conversion business segment of \$382. The Fuel Conversion business segment had no revenues associated with it.

The Company expects to incur \$582,000 of severance costs relating to the suspension of the Fuel Conversion business segment, of which \$402,000 will be paid in 2017, \$120,000 will be paid in 2018 and \$60,000 will be paid in 2019.

The Company expects to incur storage fees and other disposal costs associated with certain property, plant and equipment and contractual termination payments or other miscellaneous expenses but an estimated amount or range of amounts has not yet been determined.

4. Restructuring Activities

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The Company recorded a restructuring charge of \$58 and \$119 for the three and six months ended June 30, 2017, respectively, in connection with the workforce reduction. The charge consisted primarily of one-time severance payments and benefit continuation costs. The following is a reconciliation of the accrual for the workforce reduction for the three and six months ending June 30, 2017 and 2016:

	Three Months Ended		Six Months Ended	
	2017	2016	2017	2016
Restructuring liability at January 1,	\$186	\$13	\$309	\$ —
Amounts expensed	58	—	119	317
Amounts expensed - discontinued operations	396	—	396	—
Amounts paid	(88)	(13)	(272)	(317)
Restructuring liability at June 30,	\$552	\$—	\$552	\$ —

5. Accumulated Other Comprehensive Loss

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

	Three Months Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Foreign currency translation				
Balance at beginning of period	\$(1,458)	\$(1,139)	\$(1,574)	\$(1,568)
Other comprehensive loss:				
Foreign currency translation adjustments (1)	380	(111)	496	318
Balance at end of period	\$(1,078)	\$(1,250)	\$(1,078)	\$(1,250)
Available-for-sale marketable securities				
Balance at beginning of period	\$7	\$9	\$6	\$12
Other comprehensive income:				
Net unrealized holding gain (loss) (2)	—	(5)	1	(8)
Balance at end of period	\$7	\$4	\$7	\$4
Total accumulated other comprehensive loss	\$(1,071)	\$(1,246)	\$(1,071)	\$(1,246)

(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.

6. Treasury Stock

Common stock held in treasury totaled 644,091 and 354,889 with a cost of \$1,472 and \$1,214 at June 30, 2017 and December 31, 2016, respectively. These shares were withheld from employees to settle personal tax withholding obligations that arose as a result of restricted stock units that have vested in the periods presented.

7. Earnings per Share

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-the-money stock options are excluded from diluted earnings per share because they are anti-dilutive. For the three and six months ended June 30,

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2017 and 2016, 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 months ended June 30, 2017 and 2016.

	Three Months Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Basic weighted-average shares	23,738,000	23,381,000	23,606,000	23,283,000
Conversion of unsecured loan notes	—	—	—	—
Unexercised options and unvested RSUs	—	—	—	—
Diluted weighted-average shares	23,738,000	23,381,000	23,606,000	23,283,000

Fuel Tech had 1,432,000 and 2,149,000 weighted average equity awards outstanding at June 30, 2017 and 2016, 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.

8. Stock-Based Compensation

Under our stock-based employee compensation plan, referred to as the Fuel Tech, Inc. 2014 Long-Term Incentive Plan (Incentive Plan), awards may be granted to participants in the form of Non-Qualified Stock Options, Incentive Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units (“RSUs”), Performance Awards, Bonuses or other forms of share-based or non-share-based awards or combinations thereof. Participants in the Incentive Plan may be our directors, officers, employees, consultants or advisors (except consultants or advisors in capital-raising transactions) as the directors determine are key to the success of our business. There are a maximum of 4,400,676 shares that may be issued or reserved for awards to participants under the Incentive Plan. As of June 30, 2017, Fuel Tech had 1,621,941 shares available for share-based awards under the 2014 Plan.

We adopted the provisions of ASU 2016-09 as of January 1, 2017. Pursuant to this adoption, we recorded any excess tax benefits within income tax expense for the three and six months ended June 30, 2017, where previously these were recorded as increases or decreases to additional paid-in capital. This change has been applied prospectively effective January 1, 2017, and therefore no adjustments were made to prior periods. Given the Company has a full valuation allowance on its deferred tax assets, there were no excess tax benefits to record for the three and six month periods ended June 30, 2017. In addition, we have continued to account for forfeitures of awards based on an estimate of the number of awards expected to be forfeited and adjusting the estimate when it is no longer probable that the employee will fulfill the service condition. In accordance with the guidance, we retrospectively reported cash paid on behalf of employees for withholding shares for tax-withholding purposes as a financing activity in the Consolidated Statement of Cash Flows. Additionally, there were no excess tax benefits for the three and six months ended June 30, 2017. Any future excess tax benefits will be classified as an operating activity, applied prospectively. The adoption of this ASU did not result in a material change in our earnings, cash flows, or financial position.

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 six months ended June 30, 2017 and 2016 were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Stock options and restricted stock units, net of forfeited	\$1,166	\$580	\$1,156	\$1,041
Tax benefit of stock-based compensation expense	—	—	—	—
After-tax effect of stock-based compensation (1)	\$1,166	\$580	\$1,156	\$1,041

(1) The increase in stock-based compensation expense is due to the accelerated vesting of outstanding remaining restricted stock units approved by the Company's Board of Directors on June 28, 2017.

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.

Stock option activity for Fuel Tech's Incentive Plans for the six months ended June 30, 2017 was as follows:

	Number of Options	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding on January 1, 2017	1,039,750	\$ 8.39		
Granted	—	—		
Exercised	—	—		
Expired or forfeited	(50,000)	26.15		
Outstanding on June 30, 2017	989,750	\$ 7.49	4.27	\$ —
Exercisable on June 30, 2017	989,750	\$ 7.49	4.27	\$ —

As of June 30, 2017, there was no 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 period between two and four years). Such time-vested RSUs are valued at the date of grant using the intrinsic value method based on the closing price of the Common Shares on the grant date. Compensation cost, adjusted for estimated forfeitures, is amortized on a straight-line basis over the requisite service period. As part of the Company's planned initiatives to help improve our financial results commencing with the second half of this year, on June 28, 2017, the Compensation Committee of the Fuel Tech, Inc. Board of Directors, acting pursuant to its authority under the Company's Long-Term Incentive Plans, approved accelerating the vesting date to June 28, 2017 for all remaining outstanding time-vested RSUs that were unvested at that date and recorded a charge of \$798 in excess of the amount scheduled to be expensed.

In addition to the time vested RSUs described above, performance-based RSU agreements (the Agreements) are issued annually to our Executive Chairman; President/Chief Executive Officer; Senior Vice President, Fuel Conversion Marketing; Senior Vice President, Treasurer/Chief Financial Officer; and Senior Vice President, General Counsel and Corporate Secretary. 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 our 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 June 30, 2017, there is \$105 of unrecognized compensation costs related to performance based restricted stock unit awards to be recognized over a weighted average period of 2.00 years.

A summary of restricted stock unit activity for the six months ended June 30, 2017 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested restricted stock units at January 1, 2017	1,463,796	\$ 2.82
Granted	—	—
Forfeited	(213,001)	2.99
Vested	(981,633)	2.85
Unvested restricted stock units at June 30, 2017	269,162	\$ 2.57

The fair value of restricted stock that vested during the six month period ending June 30, 2017 was \$890.

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 six-month periods ended June 30, 2017 and 2016, Fuel Tech recorded no stock-based compensation expense under the Deferred Plan.

9. Debt Financing

On June 16, 2017, the Company amended its existing U.S. Domestic credit facility with JPM Chase to extend the maturity date to June 28, 2019. There are no financial covenants set forth in this amendment to the Facility. The credit availability under the Facility remains at \$5,000 with this amendment, and further, JPM Chase's current Revolving Commitment under the Facility remains secured by cash held by the Company in a separate restricted use designated JPM Chase deposit account. The amount of credit available to the Company under the Facility is \$5,000 and will remain as such until the Maturity Date of the Facility on June 28, 2019. During the entire period of the Facility the Company must maintain sufficient cash balances in a segregated deposit account equal to the amount of the Facility and has fully pledged such cash as collateral to the bank to support the credit available to the Company under the Facility. As of June 30, 2017 and December 31, 2016, there were no outstanding borrowings on the credit facility. At June 30, 2017 and December 31, 2016, the Company had outstanding standby letters of credit and bank guarantees totaling approximately \$3,054 and \$3,292, respectively, under the 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. The Company pays a commitment fee of 0.25% per year on the unused portion of the revolving credit facility. At June 30, 2017 and December 31, 2016, approximately \$1,946 and \$1,708 was available for future borrowings under the Facility.

On June 16, 2017, 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 6.5 million (approximately \$959), which expires on June 29, 2018. The current facility for Beijing Fuel Tech is also secured by cash held by the Company in a separate restricted use designated JPM Chase deposit account. The Company intends to renew the China Facility at its maturity. This new credit facility replaced the previous RMB 6.5 million facility that expired on June 23, 2017. 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 June 30, 2017 and December 31, 2016, Beijing Fuel Tech had no cash borrowings under the China Facility.

At June 30, 2017 and December 31, 2016, the Company had outstanding standby letters of credit and bank guarantees totaling approximately \$37 and \$22, respectively, on its Beijing Fuel Tech revolving credit facility in connection with contracts in process. At June 30, 2017 and December 31, 2016, approximately \$922 and \$914 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.

10. Business Segment and Geographic Financial Data

Business Segment Financial Data

Effective June 28, 2017, the Company has suspended all operations associated with the Fuel Conversion business segment. We now segregate our financial results into two reportable segments representing two broad technology segments as follows:

The Air Pollution Control technology segment includes technologies to reduce NO_x emissions in flue gas from boilers, incinerators, furnaces and other stationary combustion sources. These include Low and Ultra Low NO_x Burners (LNB and ULNB), Over-Fire Air (OFA) systems, NO_xOUT[®] and HERT[™] Selective Non-Catalytic Reduction (SNCR) systems, and Advanced Selective Catalytic Reduction (ASCR)[™] systems. Our ASCR systems include ULNB, OFA, and SNCR components, along with a downsized SCR catalyst, Ammonia Injection Grid (AIG), and Graduated Straightening Grid GSG[™] systems to provide high NO_x reductions at significantly lower capital and operating costs than conventional SCR systems. The NO_xOUT CASCADE[®] and NO_xOUT-SCR[®] processes are more basic, using just SNCR and SCR catalyst components. ULTRA[™] technology creates ammonia at a plant site using safe urea for use with any SCR application. Flue Gas Conditioning systems are chemical injection systems offered in markets outside the U.S. and Canada to enhance electrostatic precipitator and fabric filter performance in controlling particulate emissions.

The FUEL CHEM[®] technology segment, which uses chemical processes in combination with advanced CFD and 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 to either reportable segment. There are no inter-segment sales that require elimination.

We evaluate performance and allocate 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). We do not review assets by reportable segment, but rather, in aggregate for the Company as a whole.

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

Three months ended June 30, 2017	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Revenues from external customers	\$ 5,545	\$ 4,196	\$—	\$9,741
Cost of sales	(4,103)	(2,013)	—	(6,116)
Gross margin	1,442	2,183	—	3,625
Selling, general and administrative	—	—	(5,923)	(5,923)
Restructuring charge	(58)	—	—	(58)
Research and development	—	—	(280)	(280)
Building Impairment	—	—	(2,965)	(2,965)
Operating income (loss)	\$ 1,384	\$ 2,183	\$(9,168)	\$(5,601)

Three months ended June 30, 2016	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Revenues from external customers	\$ 10,031	\$ 5,144	\$—	\$15,175
Cost of sales	(7,152)	(2,443)	—	(9,595)
Gross margin	2,879	2,701	—	5,580
Selling, general and administrative	—	—	(6,760)	(6,760)
Restructuring charge	—	—	—	—
Research and development	—	—	(295)	(295)
Operating income (loss)	\$ 2,879	\$ 2,701	\$(7,055)	\$(1,475)

Six months ended June 30, 2017	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Net Sales from external customers	\$ 9,547	\$ 8,685	\$—	\$18,232
Cost of sales	(6,603)	(4,282)	—	(10,885)
Gross margin	2,944	4,403	—	7,347
Selling, general and administrative	—	—	(11,077)	(11,077)
Restructuring charge	(58)	(61)	—	(119)
Research and development	—	—	(564)	(564)
Building Impairment	—	—	(2,965)	(2,965)
Operating income (loss)	\$ 2,886	\$ 4,342	\$(14,606)	\$(7,378)

Six months ended June 30, 2016	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Net Sales from external customers	\$ 23,021	\$ 9,976	\$—	\$32,997
Cost of sales	(16,471)	(4,898)	—	(21,369)
Gross margin	6,550	5,078	—	11,628
Selling, general and administrative	—	—	(13,922)	(13,922)
Restructuring charge	(164)	(153)	—	(317)
Research and development	—	—	(766)	(766)
Operating income (loss)	\$ 6,386	\$ 4,925	\$(14,688)	\$(3,377)

Geographic Segment Financial Data

Information concerning our 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 June 30, 2017		Six Months Ended June 30, 2017	
	2016		2016	
Revenues:				
United States	\$5,915	\$12,255	\$12,649	\$26,685
Foreign	3,826	2,920	5,583	6,312
	\$9,741	\$15,175	\$18,232	\$32,997
	June 30,	December 31,		
	2017	2016		
Assets:				
United States	\$29,619	\$ 37,684		
Foreign	19,439	20,104		
	\$49,058	\$ 57,788		

11. Contingencies

Fuel Tech is subject to various claims and contingencies related to, among other things, workers compensation, general liability (including product liability), and lawsuits. The Company records liabilities where a contingent loss is probable and can be reasonably estimated. If the reasonable estimate of a probable loss is a range, the Company records the most probable estimate of the loss or the minimum amount when no amount within the range is a better estimate than any other amount. The Company discloses a contingent liability even if the liability is not probable or the amount is not estimable, or both, if there is a reasonable possibility that a material loss may have been incurred. 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 six months June 30, 2017 and 2016, are summarized below:

	Six Months Ended June 30, 2017 2016	
Aggregate product warranty liability at beginning of period	\$ 159	\$ 268
Net aggregate (benefit) related to product warranties	—	(109)
Aggregate reductions for payments	—	—
Aggregate product warranty liability at end of period	\$ 159	\$ 159

12. Income Taxes

The Company's effective tax rate is 0% and 2% for the six-month periods ended June 30, 2017 and 2016, respectively. The Company's effective tax rate differs from the statutory federal tax rate of 34% for the three- and six-month periods ended June 30, 2017 primarily due to a full valuation allowance recorded on our United States, China and Italy deferred tax assets since we cannot anticipate when or if we will have sufficient taxable income to utilize the deferred tax assets in the future. Further, our effective tax rate differs from the statutory federal tax rate due 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 for the three and six month periods ended June 30, 2017 and 2016, respectively.

Fuel Tech had no unrecognized tax benefits as of June 30, 2017 and December 31, 2016.

13. 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 for goodwill evaluation purposes: the FUEL CHEM® technology segment and the APC technology segment. There is no goodwill associated with our APC segment. At both June 30, 2017 and December 31, 2016, our entire goodwill balance of \$2,116 was allocated to the FUEL CHEM® technology segment.

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. There were no indications of goodwill impairment in the six months ended June 30, 2017 and 2016.

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.

With the exception of the impairment disclosed in Note 1, there were no indications of intangible asset impairment in the six-month periods ended June 30, 2017 and 2016.

14. Fair Value Measurements

We apply 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 or 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

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 three and six months ended June 30, 2017 and 2016.

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.

The following table summarizes the Company's assets measured at fair value on a non-recurring basis relating to the building impairment charge recognized during the second quarter of 2017, as more fully described in Note 2.

	Level 1	Level 2	Level 3	Impairment Losses	Fair Value at June 30, 2017
Building	\$	–	–\$7,965	\$ (2,965)	\$5,000
	\$	–	–\$7,965	\$ (2,965)	\$5,000

FUEL TECH, INC.

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

Revenues for the three- and six-month periods ending June 30, 2017 and 2016 were \$9,741 and \$15,175, and \$18,232 and \$32,997, respectively, representing decreases of \$5,434 or 36% and \$14,765 or 45% versus the same periods last year.

The Air Pollution Control (APC) technology segment generated revenues of \$5,545 and \$9,547 for the three- and six-month periods ending June 30, 2017, representing a decrease of \$4,486 or 45% and \$13,474 or 59% from the prior year amounts of \$10,031 and \$23,021, respectively. The decrease in APC revenue was principally related to historically low backlog of \$8,030 at December 31, 2016 resulting from a lack of new APC orders in the second half of the year. Revenues in our APC technology segment, which had been growing into 2013 largely through international sales, are adversely affected by a number of factors. First, the U.S. regulatory environment, while remaining favorable for our prospects, has not spurred capital investment in our products by electric power producers. Second, while general economic conditions in the U.S. have improved, energy demand for coal fired power plants has declined as utilities have switched to lower cost natural gas sources. At the same time, these sources have generally allowed utilities to meet their regulatory objectives with existing emissions investments. Sales in foreign locations have not been robust enough to offset reduced demand in the U.S.

Consolidated APC backlog at June 30, 2017 was \$21,461 versus backlog at December 31, 2016 of \$8,030. Our current backlog consists of U.S. domestic projects totaling \$11,005 and international projects totaling \$10,456.

The FUEL CHEM® technology segment generated revenues of \$4,196 and \$8,685 for the three- and six-months ended June 30, 2017. For the three and six-month periods, this represents a decrease of \$948 or 18% and \$1,291 or 13% from the prior year amounts of \$5,144 and \$9,976, respectively. 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 the three-month periods ended June 30, 2017 and 2016 was 37% for both periods and was 40% and 35% for the six-month periods then ended. The gross margin percentage for the APC technology segment for the three-month periods ended June 30, 2017 and 2016 was 26% and 29%, respectively, and was 31% and 28% for the six-month periods ended June 30, 2017 and 2016, respectively. For the FUEL CHEM technology segment, the gross margin percentage decreased to 52% from 53% for the three-month periods ending June 30, 2017 and 2016. For the six-month periods, the gross margin percentage for the FUEL CHEM technology segment was 51% for both the six-month periods ending June 30, 2017 and 2016.

Selling, general and administrative expenses (SG&A) for the three- and six-month periods ended June 30, 2017 were \$5,923 and \$11,077, respectively, and for the same periods in 2016 were \$6,760 and \$13,922, respectively. For the three-month period ended June 30, 2017, this represents a decrease of \$837, which was primarily the result of decreases in employee related costs of \$492, professional and consulting services of \$275, and other administrative expenses of \$656, partially offset by increases in stock compensation expense of \$587 due to the accelerated vesting of outstanding remaining restricted stock units approved by the Company's Board of Directors on June 28, 2017. SG&A for the six month period ended June 30, 2017 decreased by \$2,845, which was primarily the result of decreases in employee related costs of \$853, professional and consulting services of \$461, administrative costs associated with our foreign operations of \$395, and other administrative expenses of \$1,136. SG&A as a percentage of revenues increased to 61% from 45% in the three-month periods ending June 30, 2017 and 2016, and it decreased to 61% from 42% in the six-month periods ending June 30, 2017 and 2016. The increase in SG&A percentage is attributed to the decrease in revenues due to soft electric demand and low natural gas prices.

In July 2016, the Company reduced its workforce to better align its organizational infrastructure to its revised operating plans. The Company continued to reduce its workforce during the three and six months ended June 30, 2017. The Company recorded a charge of \$58 and \$119 for the three- and six-month periods ended June 30, 2017, respectively, in connection with the workforce reduction. The Company recorded a charge of \$0 and \$317 for the three- and six-month periods ended June 30, 2016. The charge consisted primarily of one-time severance payments and benefit continuation costs. For further information related to restructuring, refer to Note 4 - Restructuring Activities.

Research and development expenses for the three- and six-month periods ended June 30, 2017 were \$280 and \$564, respectively, and for the same periods in 2016 were \$295 and \$766 respectively. Effective June 28, 2017, the Company has suspended all operations associated with the Fuel Conversion business segment and the costs associated are included in Loss from discontinued operations line of the Consolidated Statements of Operations for the three- and six-month periods ended June 30, 2017 and 2016. The remaining expenditures in our Research and development expenses were focused on new product development for our APC and Fuel Chem businesses. We plan to continue focusing on increased research and development efforts in the pursuit of commercial applications for technologies outside of our traditional markets, and in the development and analysis of new technologies that could represent incremental market opportunities.

Income tax benefit for the three- and six-month periods ended June 30, 2017 and 2016 were \$15 and \$(111), and \$15 and \$94, respectively. The Company is projecting a consolidated effective tax rate of 0% for 2017 which was lower than the federal income tax rate of 34%. The Company's effective tax rate differs from the statutory federal tax rate of 34% for the three- and six- months ended June 30, 2017 primarily due to a full valuation allowance recorded on our United States, China and Italy deferred tax assets since we cannot anticipate when or if we will have sufficient taxable income to utilize the deferred tax assets in the future. Further, our effective tax rate differs from the statutory federal tax rate due 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.

Liquidity and Sources of Capital

At June 30, 2017, Fuel Tech had unrestricted cash and cash equivalents and short-term investments on hand of \$6,576 (excluding restricted cash of \$6,020) and working capital of \$18,067 versus \$11,826 (excluding restricted cash of \$6,020) and \$26,585 at December 31, 2016, respectively.

Operating activities used cash of \$5,252 during the six-month period ended June 30, 2017. This decrease in cash from operations was due to our net loss of \$9,360, a decrease in accounts payable of \$1,591, and an increase in inventory of \$570, offset by cash provided by a increase in our accrued liabilities and other non-current liabilities of \$323, a decrease in prepaid and other assets of \$16, and the effect of non-cash charges of \$5,357.

Investing activities used cash of \$232 during the six-month period ended June 30, 2017 and related to net cash used for purchases of equipment and patents.

Financing activities used cash of \$258 during the six-month period ended June 30, 2017 all of which related to cash used for the acquisition of common shares held in treasury that were withheld for taxes due by employees upon vesting of restricted stock units.

On June 16, 2017, the Company amended its existing U.S. Domestic credit facility with JPM Chase to extend the maturity date to June 28, 2019. There are no financial covenants set forth in this amendment to the Facility. The credit availability under the Facility remains at \$5,000 with this amendment, and further, JPM Chase's current Revolving Commitment under the Facility is now secured by cash held by the Company in a separate restricted use designated JPM Chase deposit account. The amount of credit available to the Company under the Facility is \$5,000 and will remain as such until the Maturity Date of the Facility on

June 28, 2019. During the entire period of the Facility the Company must maintain sufficient cash balances in a segregated deposit account equal to the amount of both the US and Beijing Facilities and will fully pledge such cash as collateral to the bank to support the credit available to the Company under the Facilities. As of June 30, 2017 and December 31, 2016, there were no outstanding borrowings on the credit facility.

At June 30, 2017 and December 31, 2016, the Company had outstanding standby letters of credit and bank guarantees totaling approximately \$3,054 and \$3,292, respectively, under the 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. The Company pays a commitment fee of 0.25% per year on the unused portion of the revolving credit facility. At June 30, 2017 and December 31, 2016, approximately \$1,946 and \$1,708 was available for future borrowings under the Facility.

On June 16, 2017, 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 6.5 million (approximately \$959), which expires on June 29, 2018. The current facility for Beijing Fuel Tech is also secured by cash held by the Company in a separate restricted use designated JPM Chase deposit account. The Company intends to renew the China Facility at its maturity. This new credit facility replaced the previous RMB 6.5 million facility that expired on June 23, 2017. 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 June 30, 2017 and December 31, 2016, Beijing Fuel Tech had no cash borrowings under the China Facility.

At June 30, 2017 and December 31, 2016, the Company had outstanding standby letters of credit and bank guarantees totaling approximately \$37 and \$22, respectively, on its Beijing Fuel Tech revolving credit facility in connection with contracts in process. At June 30, 2017 and December 31, 2016, approximately \$922 and \$914 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.

We continue to monitor our liquidity needs and in response to our continued losses have taken measures to reduce expenses and restructure operations which we feel are necessary to ensure we maintain sufficient working capital and liquidity to operate the business and invest in our future.

We have sustained losses from continuing operations for the first six months of 2017 totaling \$7,361. Our cash used in operations for this same period totaled \$3,936. We incur on an annualized basis approximately \$5.5 million in non-cash expenses for depreciation, amortization and stock compensation. We have taken measures to reduce our expense infrastructure, and over the past two years have eliminated approximately \$15 million in aggregate expense through headcount and other operating expense cutbacks.

Our cash balance as of June 30, 2017 totaled \$12,596 (including restricted cash of \$6,020), and our working capital totaled \$18,067. We do not have any outstanding debt obligations other than our letters of credit, and our current credit agreement does not have any financial covenants as we have moved to a cash collateralized line of credit with our lender.

We have evaluated our ongoing business needs, and considered the cash requirements of our base business of Air Pollution Control and Fuel Chem, as well as our efforts to support our Fuel Conversion business. This evaluation included consideration of the following: a) customer and revenue trends in our APC and Fuel Chem business segments, b) current operating structure and expenditure levels, and c) support for our Fuel Conversion business and other research and development initiatives.

We currently have a \$5 million domestic U.S. credit facility which we use to issue letters of credit to our customers. During 2016 that credit facilities for our US and Beijing operations were converted to fully cash collateralized lines of

credit requiring us to deposit funds in a restricted cash account to support that credit line. We expect to continue operating under this arrangement for the foreseeable future. Our liquidity may be adversely affected to the extent we are required to collateralize further letters of credit by additional cash deposits.

Based on this analysis, management believes that currently we have sufficient cash and working capital to operate our base APC and Fuel Chem businesses.

Contingencies and Contractual Obligations

Fuel Tech issues a standard product warranty with the sale of its products to customers as discussed in Note 10. There was no change in the warranty liability balance during the six-months ended June 30, 2017.

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 words 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, 2016 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 8 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, 2017.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Fuel Tech maintains disclosure controls and procedures and internal controls designed to ensure (a) that information required to be disclosed in Fuel Tech’s filings under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and (b) that such information is accumulated and communicated to management, including the principal executive and financial officer, as appropriate to allow timely decisions regarding required disclosure. Fuel Tech’s Chief Executive Officer and Chief Financial Officer have evaluated the Company’s disclosure controls and procedures, as defined in Rules 13a – 15(e) and 15d -15(e) of the Exchange Act, as of the end of the period covered by this report, and they have concluded that these controls and procedures are effective.

Changes in Internal Control over Financial Reporting

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

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, 2016 have not materially changed except for the elimination of the following risk factors associated with the Fuel Conversion business segment following the suspension of operations effective June 28, 2017:

Our Fuel Conversion Business is in its Early Stages of Development

We may be unable to obtain, maintain or renew permits or leases necessary for future operations of our Fuel Conversion business, which could hinder our ability to commence future operations

The following risk factor is added associated with the intended disposition of the Fuel Conversion business segment including certain property, plant and equipment and the intangible asset:

We may not be able to recover a significant portion of our carrying value of our assets held for sale associated with our Fuel Conversion business segment

Effective June 28, 2017, the Company has suspended all operations associated with the Fuel Conversion business segment. We may not be able to realize as much value from the sale of the assets as we expect and we may incur higher than expected, or unforeseen, costs associated with the disposal related activities. Any of the foregoing could have a material adverse effect on our business, financial position and results of operations.

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

None

Item 6. Exhibits

a. Exhibits (all filed herewith)

- 10.1 Ninth Amendment to Credit Agreement, dated as of June 16, 2017, between JPMorgan Chase Bank, N.A. and Fuel Tech, Inc.
- 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: August 14, 2017 By: /s/ Vincent J. Arnone

Vincent J. Arnone
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 14, 2017 By: /s/ David S. Collins

David S. Collins
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)