

FUELCELL ENERGY INC
Form 10-Q
September 10, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the quarterly period ended July 31, 2007

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the transition period from _____ to _____

Commission File Number 1-14204

FUELCELL ENERGY, INC.

(Exact name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

06-0853042
(I.R.S. Employer
Identification Number)

**3 Great Pasture Road
Danbury, Connecticut**
(Address of Principal Executive Offices)

06813
(Zip Code)

(203) 825-6000

(Registrant's telephone number, including area code)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Common Stock, par value \$.0001 per share, outstanding at September 6, 2007: 67,996,271

FUELCELL ENERGY, INC.

FORM 10-Q

As of and For the Three and Nine Month Periods Ended July 31, 2007

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FUELCELL ENERGY, INC.
Consolidated Balance Sheets
(Unaudited)

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

	July 31, 2007	October 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 106,100	\$ 26,247
Investments: U.S. treasury securities	61,442	81,286
Accounts receivable, net of allowance for doubtful accounts of \$96 and \$43, respectively	10,161	9,402
Inventories, net	23,911	14,121
Other current assets	7,664	2,653
Total current assets	209,278	133,709
Property, plant and equipment, net		
Investments: U.S. treasury securities	—	13,054
Investment and loan to affiliate	12,438	11,483
Other assets, net	287	270
Total assets	\$ 262,863	\$ 206,652
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt and other liabilities	\$ 1,005	\$ 653
Accounts payable	8,022	12,508
Accrued liabilities	7,790	6,418
Deferred license fee income	—	38
Deferred revenue and customer deposits	20,995	9,785
Total current liabilities	37,812	29,402
Long-term deferred revenue	4,844	5,162
Long-term debt and other liabilities	611	678
Total liabilities	43,267	35,242
Redeemable minority interest	11,464	10,665
Redeemable preferred stock (\$0.01 par value, liquidation preference of \$64,120 at July 31, 2007 and October 31, 2006.)	59,950	59,950
Shareholders' equity:		
Common stock (\$.0001 par value); 150,000,000 shares authorized at July 31, 2007 and October 31, 2006; 67,931,459 and 53,130,901 shares issued and outstanding at July 31, 2007 and October 31, 2006, respectively.	7	5
Additional paid-in capital	570,110	470,045
Accumulated deficit	(421,935)	(369,255)
Treasury stock, Common, at cost (12,282 and 15,583 shares in 2007 and 2006, respectively.)	(126)	(158)
Deferred compensation	126	158
Total shareholders' equity	148,182	100,795

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Total liabilities and shareholders' equity	\$	262,863	\$	206,652
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See accompanying notes to consolidated financial statements.

FUELCELL ENERGY, INC.
Consolidated Statements of Operations
(Unaudited)
(Dollars in thousands, except share and per share amounts)

	Three Months Ended	
	July 31,	
	2007	2006
Revenues:		
Product sales and revenues	\$ 7,807	\$ 5,376
Research and development contracts	5,737	3,307
Total revenues	13,544	8,683
Costs and expenses:		
Cost of product sales and revenues	14,903	15,240
Cost of research and development contracts	4,718	2,647
Administrative and selling expenses	4,676	4,320
Research and development expenses	6,980	6,621
Total costs and expenses	31,277	28,828
Loss from operations	(17,733)	(20,145)
License fee expense, net	—	(7)
Interest expense	(24)	(22)
Loss from equity investments	(414)	(275)
Interest and other income, net	3,152	1,737
Loss before redeemable minority interest	(15,019)	(18,712)
Redeemable minority interest	(421)	—
Loss before provision for income taxes	(15,440)	(18,712)
Provision for income taxes	—	—
Net loss	(15,440)	(18,712)
Preferred stock dividends	(802)	(1,082)
Net loss to common shareholders	\$ (16,242)	\$ (19,794)
Loss per share basic and diluted:		
Net loss per share to common shareholders	\$ (0.24)	\$ (0.37)
Basic and diluted weighted average shares outstanding	67,939,527	53,116,670

See accompanying notes to consolidated financial statements.

FUELCELL ENERGY, INC.
Consolidated Statements of Operations
(Unaudited)
(Dollars in thousands, except share and per share amounts)

	Nine Months Ended July 31,	
	2007	2006
Revenues:		
Product sales and revenues	\$ 21,567	\$ 14,863
Research and development contracts	10,194	9,298
Total revenues	31,761	24,161
Costs and expenses:		
Cost of product sales and revenues	44,679	40,332
Cost of research and development contracts	8,758	8,283
Administrative and selling expenses	13,866	13,238
Research and development expenses	20,489	17,898
Total costs and expenses	87,792	79,751
Loss from operations	(56,031)	(55,590)
License fee income, net	34	45
Interest expense	(72)	(76)
Loss from equity investments	(1,032)	(715)
Interest and other income, net	5,654	4,491
Loss before redeemable minority interest	(51,447)	(51,845)
Redeemable minority interest	(1,233)	—
Loss before provision for income taxes	(52,680)	(51,845)
Provision for income taxes	—	—
Net loss	(52,680)	(51,845)
Preferred stock dividends	(2,406)	(8,139)
Net loss to common shareholders	\$ (55,086)	\$ (59,984)
Loss per share basic and diluted:		
Net loss per share to common shareholders	\$ (0.92)	\$ (1.19)
Basic and diluted weighted average shares outstanding	59,967,137	50,341,771

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended July 31,	
	2007	2006
Cash flows from operating activities:		
Net loss	\$ (52,680)	\$ (51,845)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	3,939	3,211
Loss in equity investments	1,032	715
Interest receivable from loan to affiliate	(23)	—
Loss on redeemable minority interest	1,233	—
Gain on derivative	65	—
Depreciation and amortization	7,004	6,820
Amortization (accretion) of bond premium (discount)	(574)	97
Provision for doubtful accounts	53	34
(Increase) decrease in operating assets:		
Accounts receivable	(812)	317
Inventories	(5,847)	(2,547)
Other assets	(4,981)	(550)
Increase (decrease) in operating liabilities:		
Accounts payable	(4,486)	3,289
Accrued liabilities	2,497	1,057
Deferred revenue and customer deposits	10,892	1,919
Deferred license fee income and other	(38)	74
Net cash used in operating activities	(42,726)	(37,409)
Cash flows from investing activities:		
Capital expenditures	(3,487)	(9,469)
Loan to affiliate	(2,000)	—
Treasury notes matured	270,609	149,900
Treasury notes purchased	(237,137)	(106,844)
Net cash provided by investing activities	27,985	33,587
Cash flows from financing activities:		
Repayment of debt	(318)	(458)
Proceeds from debt	354	—
Payment of preferred dividends	(2,840)	(8,129)
Net proceeds from sale of common stock	95,457	7,812
Common stock issued for option and stock purchase plans	1,941	1,375
Net cash provided by financing activities	94,594	600
Net increase in cash and cash equivalents	79,853	(3,222)
Cash and cash equivalents-beginning of period	26,247	22,702

Cash and cash equivalents-end of period	\$	106,100	\$	19,480
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See accompanying notes to consolidated financial statements.

FUELCELL ENERGY, INC.
Notes to Consolidated Financial Statements
As of and for the three and nine months ended July 31, 2007 and 2006
(Unaudited)
(Tabular amounts in thousands, except share and per share amounts)

Note 1. Summary of Significant Accounting Policies

Nature of Business

FuelCell Energy Inc. (“FuelCell” or the “Company”) develops, manufactures and markets ultra-clean power plants that generate electricity 24/7 with up to twice the efficiency of conventional fossil fuel plants with virtually no air pollution and reduced greenhouse gas emissions. Our DFC power plants use a variety of fuels including renewable biogas and readily-available fuels such as natural gas and have generated more than 180 million kilowatt hours of power for commercial, industrial, municipal and utility customers. FuelCell Energy’s fuel cells are generating power at over 50 locations worldwide.

We have been developing fuel cell technology since our founding in 1969. Our core carbonate fuel cell products (“Direct FuelCell®” or “DFC Power Plants”), offer stationary applications for customers. In addition to our current commercial products, we continue to develop our next generation of carbonate fuel cell and hybrid products as well as planar solid oxide fuel cell (“SOFC”) technology with our own and government research and development funds.

Basis of Presentation - Interim Consolidated Financial Statements

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”), for interim financial information, and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not contain all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary to present fairly our financial position as of July 31, 2007 have been included. The balance sheet as of October 31, 2006 has been derived from the audited financial statements at that date.

The preparation of financial statements and related disclosures in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the period reported. Actual results could differ from those estimates.

The results of operations and cash flows for the three and nine months ended July 31, 2007 are not necessarily indicative of the results to be expected for the full year. The reader should supplement the information in this document with prior disclosures in our 2006 Annual Report on Form 10-K.

Consolidation

The consolidated financial statements include our accounts and those of our subsidiaries, including our Canadian subsidiary, FuelCell Energy, Ltd., and a subsidiary formed in April 2006, Bridgeport Fuel Cell Park, LLC, for the purpose of developing a 10 MW fuel cell park to be located in Bridgeport, Connecticut. Alliance Monterrey, LLC; Alliance Star Energy, LLC; and Alliance TST Energy, LLC are joint ventures with Alliance Power, Inc. to construct fuel cell power plants and sell power under power purchase agreements to the following customers: the City of Santa Barbara, the Sheraton San Diego Hotel & Marina, the Westin San Francisco Airport Hotel and TST, Inc., respectively.

Alliance Chico, LLC is another joint venture with Alliance Power, Inc for the development and sale of power plants for California customers. The financial results of the joint ventures are consolidated with those of the Company, which owns 80 percent of each entity. Cumulative minority interest in these Alliance entities is not material to the consolidated financial statements. Intercompany accounts and transactions have been eliminated. In January 2007, we formed a new subsidiary, Long Beach Clean Energy, LLC, for bids in New York state. We also formed an entity called DFC-ERG Milford, LLC for project activity under the Connecticut Clean Energy Fund's Project 100. No significant activity was recorded in either of these entities during the nine months ended July 31, 2007.

FUELCELL ENERGY, INC.
Notes to Consolidated Financial Statements
As of and for the three and nine months ended July 31, 2007 and 2006
(Unaudited)
(Tabular amounts in thousands, except share and per share amounts)

Certain reclassifications have been made to our prior year amounts to conform to the 2007 presentation.

Foreign Currency Translation

Our Canadian subsidiary, FuelCell Energy, Ltd., is financially and operationally integrated and therefore the temporal method of translation of foreign currencies is followed. The functional currency is U.S. dollars. Foreign currency gains and losses are classified in interest and other income on our consolidated statement of operations.

There was not a material amount of foreign currency gains or losses during the three and nine months ended July 31, 2007 and 2006.

Comprehensive Loss

Our comprehensive loss equals net loss (as reported before preferred dividends) on our consolidated statement of operations of \$15.4 million and \$52.7 million for the three and nine months ended July 31, 2007, respectively, and \$18.7 million and \$51.8 million for the three and nine months ended July 31, 2006, respectively. Comprehensive income (loss) is defined as the increase or decrease in equity from sources other than owners.

Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertain Income Taxes ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements. FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return. FIN 48 is effective for fiscal years beginning after December 16, 2006 (beginning of our fiscal 2008 on November 1, 2007). The Company is currently evaluating FIN 48 and we do not anticipate that it will have a material impact on our financial statements upon adoption due to the Company's current income tax position.

Note 2. Equity investments

Versa Power Systems, Inc. ("Versa") is one of our sub-contractors under the Department of Energy ("DOE") large-scale hybrid project to develop a coal-based, multi-megawatt solid oxide fuel cell-based hybrid system. Our equity investment in Versa totaled approximately \$10.4 million and \$11.5 million as of July 31, 2007 and October 31, 2006, respectively. Our ownership interest at July 31, 2007 was 39 percent and we account for Versa under the equity method of accounting.

During the three months ended July 31, 2007, the Company invested \$2.0 million in Versa in the form of a convertible note. This investment would bring the Company's ownership percentage in Versa to approximately 43% should this note be converted into common stock. In conjunction with this investment the Company also received warrants for the right to purchase an additional 2,286 shares of common stock with an exercise price of \$175 per share. The fair value of the warrants was approximately \$0.2 million as of July 31, 2007 and is included within Investment and loan to affiliate on the consolidated balance sheet. Changes in the fair value of the warrants will be included in the consolidated statement of operations each period.

FUELCELL ENERGY, INC.
Notes to Consolidated Financial Statements
As of and for the three and nine months ended July 31, 2007 and 2006
(Unaudited)
(Tabular amounts in thousands, except share and per share amounts)

Note 3. Investments

Our short-term investments are in U.S. treasury securities, which are held to maturity. The following table summarizes the amortized cost basis and fair value at July 31, 2007 and October 31, 2006:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
<i>At July 31, 2007</i>				
U.S. government obligations	\$ 61,442	\$ 13	\$ (37)	\$ 61,418
<i>At October 31, 2006</i>				
U.S. government obligations	\$ 94,340	\$ 24	\$ (345)	\$ 94,019

Reported as:

	July 31, 2007	October 31, 2006
Short-term investments	\$ 61,442	\$ 81,286
Long-term investments	—	13,054
Total	\$ 61,442	\$ 94,340

As of July 31, 2007, short-term investment securities have maturity dates ranging from August 15, 2007 to May 15, 2008, and estimated yields ranging from 3.02 percent to 5.59 percent. There were no long-term investment securities as of July 31, 2007. Our weighted average yield on our short-term investments was 4.37 percent as of July 31, 2007.

Note 4. Inventories

The components of inventory at July 31, 2007 and October 31, 2006 consisted of the following:

	July 31, 2007	October 31, 2006
Raw materials	\$ 10,814	\$ 5,571
Work-in-process	13,097	8,550
Total	\$ 23,911	\$ 14,121

Our inventories are stated at the lower of recoverable cost or market price. We provide for a lower of cost or market adjustment against gross inventory values. Our lower of cost or market adjustment, reducing gross inventory values to the reported amounts, was approximately \$14.2 million and \$10.8 million at July 31, 2007 and October 31, 2006, respectively.

FUELCELL ENERGY, INC.
Notes to Consolidated Financial Statements
As of and for the three and nine months ended July 31, 2007 and 2006
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Note 5. Property, Plant and Equipment

Property, plant and equipment at July 31, 2007 and October 31, 2006 consisted of the following:

	July 31, 2007	October 31, 2006	Estimated Useful Life
Land	\$ 524	\$ 524	—
Building and improvements	6,453	5,996	10-30 years
Machinery, equipment and software	52,892	50,645	3-8 years
Furniture and fixtures	2,466	2,456	6-10 years
Equipment leased to others	2,063	2,063	3 years
Power plants for use under power purchase agreements	17,743	20,576	10 years
Construction in progress ⁽¹⁾	4,636	6,316	
	\$ 86,777	\$ 88,576	
Less accumulated depreciation	(45,917)	(40,440)	
Total	\$ 40,860	\$ 48,136	

(1) Included in construction in progress are costs of approximately \$0.6 million and \$3.0 million at July 31, 2007 and October 31, 2006, respectively, to build power plants for servicing power purchase agreement contracts.

Depreciation expense was approximately \$7.0 million and \$6.6 million for the nine months ended July 31, 2007 and 2006, respectively.

In December 2006, we completed the sale of the 1 MW power plant that had been operating under a power purchase agreement to the Sierra Nevada Brewing Co. This resulted in a \$5.5 million decrease in gross property, plant and equipment, a \$1.5 million decrease in accumulated depreciation and a \$2.2 million decrease in liabilities related to the California Self-Generation Incentive Program which were assumed by the Sierra Nevada Brewing Co. Net cash proceeds from this transaction were \$1.8 million.

Note 6. Share-Based Compensation

The Company has shareholder approved equity incentive plans and a shareholder approved Section 423 Stock Purchase Plan (the "ESPP"), which are described in more detail below.

The compensation cost that has been charged against income for Share-Based Plans was \$1.2 million and \$1.1 million for the three months ended July 31, 2007 and 2006, respectively, and \$3.9 million and \$3.2 million for the nine months ended July 31, 2007 and 2006, respectively. Share-based compensation included in the consolidated statements of operations for the three and nine months ended July 31, 2007 and 2006 was as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2007	2006	2007	2006
Cost of product sales and revenues	\$ 160	\$ 162	\$ 539	\$ 472

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Cost of research and development contracts	78	47	216	139
General and administrative expense	737	680	2,334	2,063
Research and development expense	264	201	821	530
Total share-based compensation	\$ 1,239	\$ 1,090	\$ 3,910	\$ 3,204

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FUELCELL ENERGY, INC.
Notes to Consolidated Financial Statements
As of and for the three and nine months ended July 31, 2007 and 2006
(Unaudited)
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Equity Incentive Plans

The Board adopted the 1998 and 2006 Equity Incentive Plans (collectively, “the Plans”). Under the terms of the Plans, 8.5 million shares of common stock may be granted as options or stock to our officers, key employees and directors. As of July 31, 2007, 2.1 million shares were available for grant. Pursuant to the Plans, the Board is authorized to grant incentive stock options or nonqualified options and stock appreciation rights to our officers and key employees and may grant nonqualified options and stock appreciation rights to our directors. Stock options and stock appreciation rights have restrictions as to transferability. The option exercise price shall be fixed by the Board but in the case of incentive stock options, shall not be less than 100 percent of the fair market value of the shares subject to the option on the date the option is granted. Stock appreciation rights may be granted in conjunction with options granted under the Plans. Stock options that have been granted are generally exercisable commencing one year after grant at the rate of 25 percent of such shares in each succeeding year and have a ten-year maximum term. There were no stock appreciation rights outstanding at July 31, 2007 or October 31, 2006.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model that uses the assumptions noted in the following table. Expected volatility is based on a combination of the historical volatility of the Company’s stock and the implied volatility from traded options. We use historical data to estimate the expected term of options granted.

	Three Months Ended		Nine Months Ended	
	July 31,		July 31,	
	2007	2006	2007	2006
Expected life (in years)	6.62	6.27	6.53	6.31
Risk-free interest rate	4.81%	4.91%	4.55%	4.57%
Volatility	57.1%	58.1%	61.3%	56.6%
Dividend yield	—	—	—	—

The following table summarizes the Plans’ stock option activity for the nine months ended July 31, 2007:

	Number of	Weighted
	options	average
		option price
Outstanding at October 31, 2006	6,453,404	\$ 10.33
Granted	897,712	7.00
Exercised	(1,260,500)	1.69
Forfeited/Cancelled	(791,350)	15.25
Outstanding at July 31, 2007	5,299,266	11.12

The weighted average grant-date fair value of options granted during the three and nine months ended July 31, 2007 was \$4.60 and \$4.44, respectively, and was \$5.47 and \$5.92, respectively, for the three and nine months ended July 31, 2006. The total intrinsic value of options outstanding and options exercisable at July 31, 2007 was \$3.0 million and \$2.6 million, respectively. The total intrinsic value of options exercised during the three and nine months ended July 31, 2007 was \$0.01 million and \$7.2 million, respectively, and was \$0.2 million and \$2.1 million, respectively, for the three and nine months ended July 31, 2006, respectively.

FUELCELL ENERGY, INC.
Notes to Consolidated Financial Statements
As of and for the three and nine months ended July 31, 2007 and 2006
(Unaudited)
(Tabular amounts in thousands, except share and per share amounts)

The following table summarizes information about stock options outstanding and exercisable at July 31, 2007:

Range of exercise prices	Number outstanding	Options Outstanding		Options Exercisable	
		Weighted average remaining contractual life	Weighted average exercise price	Number exercisable	Weighted average exercise price
\$0.28 - \$5.10	343,800	1.4	\$ 1.72	343,800	\$ 1.72
\$5.11 - \$9.92	2,453,192	7.8	7.60	1,010,344	7.40
\$9.93 - \$14.74	1,677,656	6.6	12.21	1,108,350	12.79
\$14.75 - \$19.56	328,618	3.6	16.82	324,743	16.83
\$19.57 - \$24.39	237,000	3.7	23.00	237,000	23.00
\$24.40 - \$29.21	27,000	3.5	26.15	27,000	26.15
\$29.22 - \$34.03	168,000	3.4	29.91	168,000	29.91
\$34.04 - \$48.49	64,000	3.2	38.50	64,000	38.50
	5,299,266	6.3	\$ 11.12	3,283,237	\$ 12.60

As of July 31, 2007, total compensation cost related to nonvested stock options not yet recognized was \$9.1 million, which is expected to be recognized over the next 1.2 years on a weighted-average basis.

During the nine months ended July 31, 2007, we issued 8,391 shares of common stock with a value of \$0.07 million to directors as compensation in lieu of cash. During the nine months ended July 31, 2006, we issued 6,965 shares of common stock with a value of \$0.06 million to directors as compensation in lieu of cash. These 2006 shares were fully vested at the date of grant.

Employee Stock Purchase Plan

Our shareholders adopted the Employee Stock Purchase Plan (“ESPP”) on July 31, 1993, which has been amended from time to time by the Board. The total shares allocated to the ESPP are 900,000. Under the ESPP, eligible employees have the right to subscribe to purchase shares of common stock at the lesser of 85 percent of the high and low market prices on the first day of the purchase period or the last day of the purchase period and such purchased shares have a six month vesting period. As of July 31, 2007, there were 308,270 shares of Common Stock reserved for issuance under the ESPP.

Activity in the ESPP for the nine months ended July 31, 2007 was as follows:

	Number of Shares
Balance at October 31, 2006	355,587
Issued at \$5.63	(22,750)
Issued at \$5.61	(24,567)
Balance at July 31, 2007	308,270

The weighted-average grant date fair value of shares issued under the ESPP during the nine months ended July 31, 2007 was \$1.94.

FUELCELL ENERGY, INC.
Notes to Consolidated Financial Statements
As of and for the three and nine months ended July 31, 2007 and 2006
(Unaudited)
(Tabular amounts in thousands, except share and per share amounts)

The fair value of shares under the ESPP are determined at the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Nine months ended July 31, 2007
Expected life (in years)	0.5
Risk-free interest rate	5.06%
Volatility	46.7%
Dividend yield	—

Incentive Compensation

Stock may be issued to employees as part of FuelCell's annual incentive bonus. During the nine months ended July 31, 2007, 133,419 shares of common stock with a value of \$0.9 million were issued as incentive bonus (in lieu of cash). During the nine months ended July 31, 2006, we issued 75,585 shares of common stock with a value of \$0.7 million as incentive bonus (in lieu of cash).

Note 7. Shareholders' Equity

Changes in shareholders' equity were as follows for the nine months ended July 31, 2007:

Balance at October 31, 2006	\$ 100,795
Sale of common stock	95,512
Increase in additional paid-in-capital for stock-based compensation	3,939
Increase in additional paid-in-capital for stock issued under employee benefit plans	3,010
Increase in additional paid-in-capital for issuance of warrants	10
Series B preferred dividends	(2,406)
Change in common stock, par	2
Net loss	(52,680)
Balance at July 31, 2007	\$ 148,182

Sale of Common Stock

In April 2007, we completed a public offering of 9.4 million shares of our common stock for net proceeds of \$65.4 million. In February 2007, POSCO Power purchased approximately 3.8 million shares of our common stock, which was restricted for six months, for \$29.0 million. Additionally, we have sold 160,000 shares of our common stock on the open market during the nine months ended July 31, 2007 resulting in net proceeds of approximately \$1.1 million.

Note 8. Segment Information and Major Customers

Under SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," we use the "management" approach to reporting segments. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of reportable segments. SFAS

No. 131 also requires disclosures about products and services, geographic areas, and major customers. Under SFAS No. 131, we have identified one business segment: fuel cell power plant production and research.

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FUELCELL ENERGY, INC.

Notes to Consolidated Financial Statements

**As of and for the three and nine months ended July 31, 2007 and 2006
(Unaudited)**

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

Enterprise-wide Information

Enterprise-wide information provided on geographic revenues is based on the customer's ordering location. The following table presents revenues (greater than ten percent of our total revenues) for geographic areas:

	Three months ended		Nine months ended	
	July 31,		July 31,	
	2007	2006	2007	2006
Revenues:				
United States	\$ 9,429	\$ 6,606	\$ 21,591	\$ 18,686
Canada	*	*		