GULF ISLAND FABRICATION INC
Form 10-K
March 09, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)
x Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 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 001-34279

GULF ISLAND FABRICATION, INC.
(Exact name of registrant as specified in its charter)

Louisiana	72-1147390
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
16225 Park Ten Place, Suite 280 Houston, Texas	77084
(Address of principal executive offices)	(Zip code)

(713) 714-6100
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, no par value	The Nasdaq Stock Market LLC (Nasdaq Global Select Market)

Securities registered pursuant to Section 12(g) of the Act:
None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding twelve months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant at June 30, 2017, was approximately $166,411,000.

The number of shares of the registrant's common stock, no par value per share, outstanding as of March 9, 2018, was 15,043,068.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement prepared for use in connection with the registrant's 2018 Annual Meeting of Shareholders have been incorporated by reference into Part III of this Form 10-K.

GULF ISLAND FABRICATION, INC.
ANNUAL REPORT ON FORM 10-K FOR
THE FISCAL YEAR ENDED DECEMBER 31, 2017
TABLE OF CONTENTS

Cautionary Statement on Forward-Looking Information

This Report on Form 10-K contains forward-looking statements in which we discuss our potential future performance, primarily in the sections entitled “Business and Properties,” “Legal Proceedings,” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements are all statements other than statements of historical facts, such as projections or expectations relating to oil and gas prices, operating cash flows, capital expenditures, liquidity and tax rates. The words “anticipates,” “may,” “can,” “plans,” “believes,” “estimates,” “expects,” “projects,” “targets,” “intends,” “likely,” “will,” “should,” “to be,” “potential” and any similar expressions are intended to iden assertions as forward-looking statements.

We caution readers that forward-looking statements are not guarantees of future performance and actual results may differ materially from those anticipated, projected or assumed in the forward-looking statements. Important factors that can cause our actual results to differ materially from those anticipated in the forward-looking statements include the cyclical nature of the oil and gas industry, changes in backlog estimates, suspension or termination of projects, timing and award of new contracts, financial ability of our customers and consolidation of our customers, competitive pricing and cost overruns, entry into new line of business, ability to raise additional capital, ability to sell our South Texas Properties, advancement on the SeaOne Project, ability to negotiate an amendment to the contracts to build two multi-purpose service vessels, ability to remain in compliance with our covenants contained in our credit agreement, credit worthiness of our customers, ability to employ skilled workers, operating dangers and limits on insurance coverage, weather conditions, competition, customer disputes, adjustment to previously reported profits under percentage-of-completion method, loss of key personnel, compliance with regulatory and environmental laws, ability to utilize navigation canals, performance of subcontractors, systems and information technology interruption or failure and data security breaches and other factors described in more detail in “Risk Factors” in Item 1A of this Report on Form 10-K for the year ended December 31, 2017.

Investors are cautioned that many of the assumptions upon which our forward-looking statements are based are likely to change after the forward-looking statements are made, which we cannot control. Further, we may make changes to our business plans that could affect our results. We caution investors that we do not intend to update forward-looking statements more frequently than quarterly notwithstanding any changes in our assumptions, changes in business plans, actual experience or other changes, and we undertake no obligation to update any forward-looking statements.

PART I

Items 1 and 2. Business and Properties

Certain technical terms are defined in the “Glossary of Certain Technical Terms” beginning on page G-1.

General

Gulf Island Fabrication, Inc. ("Gulf Island"), a Louisiana corporation incorporated in 1985, and together with its subsidiaries (the "Company," "we" or "our"), is a leading fabricator of complex steel structures and marine vessels used in energy extraction and production, petrochemical and industrial facilities, power generation and alternative energy projects and shipping and marine transportation operations. We also provide related installation, hookup, commissioning, repair and maintenance services with specialized crews and integrated project management capabilities. We are currently fabricating complex modules for the construction of a new petrochemical plant and completing newbuild construction of one technologically-advanced offshore support and two multi-purpose service vessels. During 2015, we fabricated wind turbine pedestals for the first offshore wind power project in the United States. We have also constructed one of the largest liftboats servicing the Gulf of Mexico ("GOM"), one of the deepest production jackets in the GOM and the first SPAR fabricated in the United States. Our customers include U.S. and, to a lesser extent, international energy producers, petrochemical, industrial, power and marine operators. Our corporate headquarters is located in Houston, Texas, with fabrication facilities located in Houma, Jennings and Lake Charles, Louisiana, and Aransas Pass and Ingleside, Texas, each of which are marketed for sale.

Website and Electronic Posting Disclosures

Our website address is www.gulfisland.com. We make available on or through our website, without charge, as soon as reasonably practicable after such materials are electronically filed with or furnished to the Securities and Exchange Commission (“SEC”), our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports. The SEC also maintains an Internet site that contains periodic reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC’s website address is www.sec.gov. Our website and the information contained therein or connected thereto are not intended to be incorporated into this annual report on Form 10-K.

Description of Our Operations

We have structured our operations with three operating divisions and one corporate non-operating division which we believe meet the criteria of reportable segments under generally accepted accounting principles in the United States ("GAAP"). Beginning in December 2017, we created one newly formed operating division which we have named our EPC Division. EPC's operating revenues and expenses for 2017 were immaterial and it held no assets. A description of each of our divisions' operations is discussed below. See Note 13 of the Notes to Consolidated Financial Statements for the operating results and assets for each of our divisions.

Fabrication Division

Our Fabrication Division primarily fabricates structures such as offshore drilling and production platforms and other steel structures for customers in the oil and gas industry including jackets and deck sections of fixed production platforms, hull, tendon, and/or deck sections of floating production platforms (such as TLPs, SPARs, FPSOs and MinDOCs), piles, wellhead protectors, subsea templates, and various production, compressor, and utility modules along with pressure vessels. Our Fabrication Division also fabricates structures for alternative energy customers (such as the five jackets and piles we constructed for the first offshore wind power project in the United States during 2015) as well as modules for petrochemical facilities. We perform these activities out of our fabrication yards in Houma,

Louisiana, and formerly out of our fabrication yards in Aransas Pass and Ingleside, Texas, each of which we are marketing for sale.

Shipyard Division

Our Shipyard Division primarily manufactures newbuild and repairs various steel marine vessels in the United States including offshore supply vessels, anchor handling vessels and liftboats to support the construction and ongoing operation of offshore oil and gas production platforms, tug boats, towboats, barges and other marine vessels. We also construct drydocks to lift marine vessels out of the water. Our marine repair activities include steel repair, blasting and painting services, electrical systems repair, machinery and piping system repairs, and propeller, shaft, and rudder reconditioning. In addition, we perform conversion projects that consist of lengthening vessels, modifying vessels to permit their use for a different type of activity, and other modifications to enhance the capacity or functionality of a vessel. We perform these activities out of our shipyards in Houma, Jennings and Lake Charles, Louisiana.

Services Division

Our Services Division primarily provides interconnect piping services on offshore platforms and inshore structures along with onshore and offshore scaffolding and piping insulation services. Interconnect piping services involve sending employee crews to offshore platforms in the GOM to perform welding and other activities required to connect production equipment, service modules and other equipment on a platform. We also contract with oil and gas companies that have platforms and other structures located in the inland lakes and bays throughout the southeastern United States for various on-site construction and maintenance activities. In addition, our Services Division fabricates packaged skid units and performs various municipal and drainage projects, such as pump stations, levee reinforcement, bulkheads and other public works projects for state and local governments. We perform these activities at the customer's location or in our yard in Houma, Louisiana.

Corporate Division

Beginning in 2017, management reduced its allocation of corporate administrative costs and overhead expenses to its operating divisions in order to individually evaluate corporate administrative costs and overhead as well as to not overly burden our operating divisions with costs that do not directly relate to their operations. Accordingly, a significant portion of our corporate administrative costs and overhead expenses are retained within the results of our Corporate Division.

EPC Division

Late in the fourth quarter of 2017, SeaOne Caribbean, LLC (“SeaOne”) selected us as the prime contractor for the engineering, procurement, construction, installation, commissioning and start-up, also known as EPCIC/S, for their Compressed Gas Liquids ("CGL") Caribbean Fuels Supply Project (the "SeaOne Project”). This project will include execution of engineering, construction and installation of modules for an export facility in Gulfport, Mississippi, and import facilities in the Caribbean and South America. SeaOne’s selection of our company is non-binding and commencement of the project remains subject to a number of conditions, including agreement on the terms of the engagement with SeaOne. We have created our EPC Division to manage this project and future projects similar to it. We are working to strengthen our internal project management capabilities through the hiring of additional personnel to service this potential project. The SeaOne Project is expected to start during mid-2018 with construction expected to start later in 2018 or early 2019. As of December 31, 2017, this division's revenue and expenses were immaterial and it held no assets.

Facilities and Equipment

We perform all projects at our facilities based on availability of space and equipment. Although our division operations are generally segregated, we move labor and resources among our divisions from time to time to maximize our consolidated profitability.

Fabrication Division Facilities

Houma Fabrication Yard - In Louisiana, our main fabrication yard is located on the Houma Navigation Canal in Houma, Louisiana, approximately 30 miles from the GOM. Our Houma Fabrication Yard includes:

- 163 acres located on the east bank of the Houma Navigation Canal, of which 100 acres are developed for fabrication, including several buildings totaling 54,000 square feet of administrative offices, 267,000 square feet of covered fabrication area, over 52,300 square feet of warehouse storage area and 8,000 square feet of training and medical facilities. It also has approximately 4,650 linear feet of water frontage, which includes 1,880 feet of steel bulkheads that permit docking of vessels and the load out of heavy structures; and
- 437 acres, located on the west bank of the Houma Navigation Canal,130 acres of which are developed for fabrication and over 300 acres of which are unimproved land that could be used for expansion. It includes 6,750 linear feet of water frontage, including 2,350 feet of steel bulkhead, and has approximately 151,600 square feet of covered

fabrication area, 21,000 square feet of warehouse storage area, and two buildings providing 8,000 square feet for administrative offices.

Some of our significant Houma Fabrication Yard equipment that we own and operate includes:

- three plate bending rolls that have the capability to roll and weld steel into approximately 50,000 tons of tubular pipe sections per year;
- computerized Vernon brace coping machines that can handle pipe up to 1,500 pounds per foot and 54-inch outer diameter, and 1,000 pounds per foot and 48-inch outer diameter;

- a computerized numeric controlled plasma-arc cutting system that cuts and bevels steel up to one inch thick at a rate of 200 inches per minute and can also etch into steel for piece markings and layout markings at a rate of 300 inches per minute;
- a state of the art, fully enclosed, and environmentally friendly blast and coating facility that allows us to provide blast and paint services;
- 12 crawler cranes, which range in tonnage capacity from 230 to 500 tons each;
- 18 rubber-tired, hydraulic modular transporters (KAMAG – Type 2406) that allow fabricated deck sections that weigh as much as 3,600 tons to be transported around our Houma Fabrication Yard when used in tandem. The transporters allow easier load-out of smaller decks and provide more agility for the movement of deck sections. Each of these transporters have a 200-ton weight capacity, are easily relocated, and can be used in tandem; and
- two grit blast systems, a hydraulic plate shear, a hydraulic press brake, and various other equipment needed to build offshore structures and fabricate steel components.

Our Fabrication Facilities in Aransas Pass and Ingleside, Texas:

We have placed our properties and equipment located in Aransas Pass and Ingleside, Texas (collectively, our "South Texas Properties"), up for sale. These properties are underutilized and represent excess capacity within our Fabrication Division. All fabrication activities at our South Texas Properties have ceased and we have re-allocated all remaining backlog from these properties to our Houma Fabrication facilities. We have also reduced our workforce at our South Texas Properties to only those needed for its upkeep as we market them for sale. We do not expect the sale of these properties to impact our ability to service our deepwater customers or operate our Fabrication Division. For additional information, see also "Potential Sale of Our South Texas Properties" in Item 7. Management's Discussion and Analysis and our Risk Factors listed in Item 1A of this Report on Form 10-K. A description of our North Yard in Aransas Pass and our South Yard in Ingleside follows.

North Yard - Our North Yard (the "North Yard") in Aransas Pass, Texas, is located along the U.S. Intracoastal Waterway and is approximately three miles north of the Corpus Christi Ship Channel. This facility is situated on approximately 160 acres, of which 85 acres are dedicated to fabrication activities and 55 acres are used for the storage of steel, prefabricated elements, equipment, and spare parts. Several buildings are located on the North Yard with 328,000 square feet of covered fabrication area, 22,000 square feet of administrative office space, 61,750 square feet of warehouse storage area, 20,000 square feet of climate controlled staging area, a paint booth 16 feet by 14 feet by 125 feet and 16,000 square feet of training and medical facilities. The North Yard also has approximately 3,000 linear feet of water frontage, including approximately 1,000 feet of steel bulkhead. Some of the significant fabrication equipment that we own at the North Yard includes:

- a pipe mill equipped with a quad roll for diameters ranging from one foot six inches to ten feet, and one large diameter plate bending roll machine;
- a quad roll, for diameters ranging from three feet to 23 feet; and
- two Romar CNC-controlled flame planers which are used to cut steel plate up to 12 feet wide and 65 feet long.

South Yard - Our South Yard (the "South Yard") in Ingleside, Texas, consists of approximately 212 acres and includes a fabrication shop with 5,000 square feet of covered fabrication area and 2,700 square feet of training facilities. The South Yard also includes approximately 2,650 linear feet of water frontage, all of which is reinforced by steel bulkhead. In addition, the South Yard contains a graving dock which measures 700 feet long by 250 feet wide and 40 feet deep. The south end of the graving dock, which opens to the Corpus Christi Ship Channel, can use either a removable sheet piled wall supported by steel struts or a portable gate that can be removed and attached to seal the dock from the water in the channel, depending upon the nature of the project. The graving dock gate is a steel barge-like structure consisting of a steel reinforced wall and a buoyancy tank. The floating structure is 240 feet long x 35 feet wide x 40 feet deep.

On December 20, 2017, we granted an exclusive option to a third party for the purchase of our South Yard for a purchase price of $55 million. This option runs through April 25, 2018, which may be extended through May 25, 2018, if proper written notice and additional earnest monies are provided in accordance with the agreement. The terms of the agreement are subject to normal and customary conditions, including the third party's right to conduct

inspections of the property related to confirmation of title, surveys, environmental conditions, easements and access rights.

Some of the significant fabrication equipment that we own and have moved from the South Yard to our North Yard or our Houma Fabrication Yard includes:

- a panel line system; and
- 10 crawler cranes, which range in tonnage capacity from 230 to 1055 tons.

Shipyard Division Facilities

Owned Facilities and Equipment:

Houma Shipyard - Our Houma Shipyard shares space with our Houma Fabrication Yard located on the west bank of the Houma Navigation Canal which is described above. We recently increased the lift capacity and length of our Houma drydock used to maintain and repair third party marine vessels as well as to launch vessels from 9,000 tons to 15,000 tons and from 240 feet long to 400 feet long. The drydock is 160 feet wide and 140 feet wide between the wing walls. The bottom is ten feet deep with 30 foot walls.

We own and operate a panel line system at our Houma Shipyard that consists of a fully automated system utilized to cut, weld, and assemble panels to be used in marine vessel construction.

Leased Facilities:

Jennings Shipyard - Our Jennings Shipyard is an 180-acre complex five miles east of Jennings, Louisiana, on the west bank of the Mermentau River approximately 25 miles north of the Intracoastal waterway that we lease from a third party. The Jennings Shipyard includes over 100,000 square feet of covered fabrication area including a panel line, pipe shop and 3,000 feet of water frontage with two launch ways and four covered construction bays. The lease, including exercisable renewal options, extends through January 2045.

Lake Charles Shipyard - Our Lake Charles Shipyard is a ten-acre complex 17 miles from the GOM on the Calcasieu River near Lake Charles, Louisiana, that we sublease from a third party. The Lake Charles Shipyard includes 1,100 feet of bulkhead water frontage with a water depth of 40 feet located one mile from the main ship channel and the Gulf Intracoastal Waterway. The sublease, including exercisable renewal options (subject to sublessor renewals), extends through July 2038.

Former Prospect Shipyard - We formerly leased a 35-acre complex 26 miles from the GOM near Houma, Louisiana, from the former owner of LEEVAC Shipyards, currently one of our Senior Vice Presidents of Business Development. We terminated this lease on December 31, 2017, in accordance with its terms, and we are marketing the remaining assets located at such property for sale. See also Note 4 of the Notes to Consolidated Financial Statements.

We own the machinery and equipment at our leased facilities. These include a plasma cutter installed in 2013, nine track cranes ranging from 65 to 230 tons, four drydocks ranging from 1,500 to 3,500 tons, and a 200-ton module transporter.

Services Division Facilities

Houma Services Yard - Our Houma Services Yard is a 63-acre facility that includes buildings totaling 14,500 square feet of administrative offices, 40,800 square feet of covered fabrication area, 29,600 square feet of warehouse storage area, a 10,000 square foot blasting and coating facility and approximately 1,320 linear feet of water frontage, including 660 feet of steel bulkhead. It is located approximately a quarter of a mile from our Houma Fabrication Yard on a channel adjacent to the Houma Navigation Canal. We own three spud barges for use in connection with our inshore construction activities. Each barge is equipped with a crane with a lifting capacity of 60 to 100 tons. In addition, we own a 26 foot long by 16 foot wide tug boat with two 300 horsepower engines reducing costs on tug boat rentals. We also own nine cranes, which range in tonnage capacity from 60 to 230 tons each.

Materials and Supplies

The principal materials and supplies used in our operations by all of our divisions include standard steel shapes, steel plate, steel pipe, welding gases, fuel, oil, gasoline and paint, all of which are currently available from many sources. We do not depend upon any single supplier or source. Our Shipyard Division uses third parties for the purchase and installation of propulsion systems as well as electrical and communications systems and other equipment. Most of the steel used in our operations arrives at our fabrication yards as steel plate. The plate is cut and rolled into the form

needed or into tubular sections at rolling mills in our fabrication yards. Tubular sections (which vary in diameter up to 23 feet) can be welded together in long straight tubes to become legs or into shorter tubes to become part of the network of bracing that support the legs. Various cuts and welds in the fabrication process are performed by computer-controlled equipment that operates from data developed during the design of the structure. We use modern welding and fabrication technology, and all of our projects are manufactured in accordance with industry standards, specifications and regulations, including those published by the American Petroleum Institute, the American Welding Society, the American Society of Mechanical Engineers, the American Bureau of Shipping and the United States Coast Guard. The quality

management systems of our operating subsidiaries are certified as ISO 9001-2015 quality assurance programs. For additional information, see “Safety and Quality Assurance” below.

Standard delivery from domestic steel mills takes about about five to six weeks for as-rolled steels versus eight to 12 weeks for heat treated steels. Due to the inability of domestic mills to produce our customers’ required steel grades, we are often forced to procure material from foreign steel mills. The delivery from these foreign mills, including transit time, is currently running approximately sixteen to twenty weeks. To mitigate our risk of increasing cost of materials, we often negotiate escalation clauses in our customer contracts to increase the contract price to offset increases in cost of materials purchased during the life of the contract.

We use third-party manufacturers for propulsion, electrical and communications systems for the vessels constructed by our Shipyard Division. To mitigate our risk of increasing costs, we negotiate and purchase the equipment from the manufacturer at a fixed price.

Safety and Quality Assurance

Management is committed to the safety and health of our employees. We believe that a strong safety culture is a critical element of our success. We continue to improve and maintain a stringent safety assurance program designed to ensure the safety of our employees and allow us to remain in compliance with all applicable federal and state mandated safety regulations. We are committed to maintaining a well trained workforce and providing timely instruction to our workforce to ensure our workers have the knowledge and skills to perform their work safely while maintaining the highest standards of quality possible. We provide continuous quality safety education and training to both employees and subcontractors to ensure our people are ready for the challenges inherent in all fabrication projects. Our employees and subcontractors begin their training on their first day of employment with a comprehensive orientation class that addresses Company policies and procedures and provides clear expectations for working safely. The Company maintains a zero tolerance approach to drugs and alcohol in the workplace. We support this policy through the use of a comprehensive drug and alcohol screening program that includes initial screenings for all employees and periodic random screenings throughout employment. Our employees are given opportunities to be a part of a dedicated safety committee which is comprised of peer-elected craft employees and members of management to assist in supporting our efforts to continuously improve safety performance. Since 2012, a safety component has been included in our annual incentive program guidelines for our executive officers and other key employees.

We fabricate to the standards and regulations of the American Petroleum Institute, the American Welding Society, the American Society of Mechanical Engineers, the American Bureau of Shipping, the United States Coast Guard, the United States Navy and customer specifications. We use welding and fabrication procedures in accordance with the latest technology and industry requirements. We have in place training programs for technical fitting and welding instruction in order to upgrade our skilled labor workforce and maintain high standards of quality. In addition, we maintain on-site facilities for the non-destructive testing of all welds, a process performed by an independent contractor.

Our quality management systems are certified as ISO 9001-2015 programs. ISO 9001-2015 is an internationally recognized verification system for quality management overseen by the International Standard Organization based in Geneva, Switzerland. The certification is based on a review of our programs and procedures designed to maintain and enhance quality production and is subject to semi-annual review and full recertification every three years.

Customers and Contracting

Our principal customers for all of our divisions include large independent oil and gas companies and their contractors, petrochemical companies and marine service companies, offshore support companies, offshore and inland barge and support vessel operators, offshore construction contractors, alternative energy companies (including offshore wind), diving companies, the U.S. Army Corps of Engineers, the U.S. Coast Guard, the U.S. Navy and state and local governmental agencies and their contractors. Our international sales fluctuate from year to year depending on whether and to what extent our customers require installation of fabricated structures outside of the United States. Sales of fabricated structures installed outside the United States comprised between 0.0% and 14.0% of revenue during each of the last five years, and accounted for 0.0%, 14.0%, and 6.0% of revenue for the years ended December 31, 2017, 2016 and 2015, respectively.

A large portion of our revenue has historically been generated by only a few customers, although not necessarily the same customers from year to year. The loss of a significant customer in any given year for any reason, including a sustained decline in that customer's capital expenditure budget or competitive factors, can result in a substantial loss of revenue and could have a material adverse effect on our operating performance.

We define significant customers as those that individually comprise 10% or more of our revenues. For the year ended December 31, 2017, we had two customers who accounted for 26.9% and 12.7%, of our revenue and related to the fabrication of

four modules for one customer associated with an ethane cracker project within our Fabrication Division, and offshore hook-up and installation work for an offshore oil and gas company in our Services Division. For the year ended December 31, 2016 we had one significant customer who accounted for 23.0% and for 2015, we had two significant customers who accounted for 18.0% and 12.0% of our revenue. The shift in the mix of our largest customers from deepwater oil and gas customers to customers within the marine industry is the result of a combination of the reduced capital spending by our offshore oil and gas exploration and production customers and our diversification efforts to capitalize on the expansion of our shipbuilding capabilities following the LEEVAC transaction. See Note 11 of the Notes to Consolidated Financial Statements for a discussion of our LEEVAC transaction.

At December 31, 2017, 73.0% of our remaining backlog consists of work for four customers all within our Shipyard Division and included:

(i) Two large multi-purpose service vessels for one customer, which commenced in the first quarter of 2014 and will be completed during 2019;
(ii) Newbuild construction of four harbor tugs and will be completed in 2018 and 2019;
(iii) Newbuild construction of four harbor tugs (separate from above) and will be completed in 2018 and 2019; and
(iv) Newbuild construction of an offshore research vessel and will be completed in 2020.

See further discussion in "Backlog" in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this Report on Form 10-K. While customers may consider other factors, including the availability, capability, reputation and safety record of a contractor, we believe price and the ability to meet a customer’s delivery schedule are the principal factors weighed by customers in awarding contracts. Our contracts generally vary in length from one to twenty-four months depending on the size and complexity of the project. Generally, our contracts and projects are subject to termination or reduction in scope at any time prior to completion, at the option of the customer. Upon termination or reduction in scope, however, the customer is generally required to pay us for work performed and materials purchased through the date of termination.

Our projects are subject to the same bid procedures and are accounted for using the percentage-of-completion accounting method. Projects are typically awarded on a fixed-price, unit rate, alliance/partnering or cost-plus basis. Under fixed-price contracts, we are entitled to be paid for our work at the price fixed in the contract, subject to adjustment only for change-orders approved by the customer. As a result, we retain all cost savings but are also responsible for all cost overruns. Under a unit rate contract, material items or labor tasks are assigned unit rates of measure. The unit rates of measure will generally be an amount of dollars per ton, per foot, per square foot or per item installed. A typical unit rate contract may contain hundreds to thousands of unit rates of measure. Profit margins are built into the unit rates and, similar to a fixed price contract, we retain all cost savings but are also responsible for all cost overruns. Under typical alliance/partnering arrangements, the parties agree in advance to a target price that includes specified levels of labor and material costs and profit margins. If the project is completed at less cost than that targeted in the contract, the contract price is reduced by a portion of the savings. If the cost of completion is greater than that targeted in the contract, the contract price is increased, but generally to the target price plus the actual incremental cost of materials and direct labor costs. Accordingly, under alliance/partnering arrangements, we have some protection from cost overruns but also share a portion of any cost savings with the customer. Under cost-plus arrangements, pursuant to which we receive a specified fee in excess of our direct labor and material costs, we are protected against cost overruns but do not benefit directly from cost savings. Because we generally price materials as pass-through items on our contracts, the cost of our labor force is the primary factor affecting our operating costs. Consequently, it is essential that we control the cost and productivity of the direct labor hours worked on our projects.

Seasonality

Operations of all of our divisions have historically been subject to seasonal variations in weather conditions and daylight hours. Since most of our construction activities take place outdoors, the number of direct labor hours worked generally declines during the winter months due to an increase in rain, cold temperatures and a decrease in daylight hours. In addition, our oil and gas customers often schedule the completion of their projects during the summer months in order to take advantage of more favorable weather during such months for the installation of their

platforms. In recent years, seasonality has had less of an impact on productivity given our covered fabrication areas.

Competition

Our three significant operating divisions are highly competitive and largely influenced by oil and gas prices, which are outside of the control of our customers. We compete intensely for available projects, which are generally awarded on a competitive bid basis with customers usually requesting bids on projects one to three months prior to commencement. Although we believe price and the contractor's ability to meet a customer's delivery schedule are the principal factors in determining which fabricator

is awarded a project, customers also consider, among other things, the availability of technically capable personnel and facility space, a fabricator's efficiency, condition of equipment, reputation, safety record and customer relations. Our competitors are both domestic and abroad. Our Fabrication Division currently has one domestic competitor, Kiewit Offshore Services, Ltd., for the fabrication of deepwater projects such as large topsides and tendons, and our Shipyard Division competes with a number of domestic shipyards along the Gulf Coast including Eastern Group, Inc., Conrad Shipyard, LLC and Thoma-Sea Marine Constructors, LLC. Numerous service companies compete with our Services Divisions for projects. We expect our new EPC Division will face competition with other domestic engineering, procurement and construction companies such as State Services Co., Inc. We also face increasing competition from abroad across all of our divisions. An increasing number of foreign yards, many of which have lower fixed costs than us and our United States competitors, also compete for larger deepwater projects destined for both the GOM and international waters in addition to shipbuilding and other fabrication projects.

We believe that our competitive pricing, expertise in fabricating offshore structures and the certification of our facilities as ISO 9001-2015 fabricators will enable us to continue to compete effectively for projects destined for the GOM and international waters. We recognize, however, that foreign governments often use subsidies and incentives to create local jobs where oil and gas production is being developed. In addition, as a result of recent technological innovations, decreased transportation costs incurred by our customers when exporting structures from foreign locations to the GOM may hinder our ability to successfully bid against foreign competitors for projects. Because of subsidies, import duties and fees, taxes on foreign operators, lower wage rates in foreign countries, fluctuations in the value of the U.S. dollar, the possible imposition of tariffs on raw materials imported into the United States, and other factors, we may not be able to remain competitive with foreign contractors for large deepwater projects.

Government and Environmental Regulation

Many aspects of our operations and properties are materially affected by federal, state and local regulations, as well as certain international conventions and private industry organizations. The exploration and development of oil and gas properties located on the outer continental shelf of the United States is regulated primarily by the Bureau of Ocean Energy, Management and Enforcement ("BOEM") of the Department of Interior ("DOI"). The Secretary of the Interior, through the BOEM, is responsible for the administration of federal regulations under the Outer Continental Shelf Lands Act requiring the construction of offshore platforms located on the outer continental shelf to meet stringent engineering and construction specifications. Violations of these regulations and related laws can result in substantial civil and criminal penalties as well as injunctions curtailing operations. We believe that our operations are in compliance with these and all other regulations affecting the fabrication of platforms for delivery to the outer continental shelf of the United States. In addition, we depend on the demand for our services from the oil and gas and marine industries and, therefore, can be affected by changes in taxes, price controls and other laws and regulations affecting these industries. Offshore construction and drilling in certain areas has also been opposed by environmental groups and, in certain areas, has been restricted. To the extent laws are enacted or other governmental actions are taken that prohibit or restrict offshore construction and drilling or impose environmental protection requirements that result in increased costs to the oil and gas industry in general and the offshore construction industry in particular, our business and prospects could be adversely affected. We cannot determine to what extent future operations and earnings may be affected by new legislation, new regulations or changes in existing regulations.

The Houma Navigation Canal provides the shortest means of access from our Houma facilities to open waters. With respect to our North and South yards, the U.S. Intracoastal Waterway provides access between our yards. From our South Yard, the Corpus Christi Ship Channel provides access to the GOM. These waterways are considered to be navigable waterways of the United States and, as such, are protected by federal law from unauthorized obstructions that would hinder water-borne traffic. Federal law also authorizes maintenance of these waterways by the U.S. Army Corps of Engineers. These waterways are dredged from time to time to maintain water depth and, while federal funding for dredging has historically been provided, there is no assurance that Congressional appropriations sufficient for adequate dredging and other maintenance of these waterways will be continued indefinitely. See also "Our business is highly dependent on our ability to utilize the navigation canals adjacent to our facilities." in "Risk Factors" in Item 1A of this Report on Form 10-K.

Our operations and properties are subject to a wide variety of increasingly complex and stringent foreign, federal, state and local environmental laws and regulations, including those governing discharges into the air and water, the handling and disposal of solid and hazardous wastes, the remediation of soil and groundwater contaminated by hazardous substances and the health and safety of employees. These laws may provide for “strict liability” for damages to natural resources and threats to public health and safety, rendering a party liable for the environmental damage without regard to negligence or fault on the part of such party. See also "The nature of our industry subjects us to compliance with regulatory and environmental laws." within our Risk Factors listed in Item 1A of this Report on Form 10-K.

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended and similar laws provide for responses to and liability for releases of hazardous substances into the environment. Additionally, the Clean Air Act, the Clean

Water Act, the Resource Conservation and Recovery Act, the Safe Drinking Water Act, the Emergency Planning and Community Right to Know Act, each as amended, and similar foreign, state or local counterparts to these federal laws, regulate air emissions, water discharges, hazardous substances and wastes, and require public disclosure related to the use of various hazardous substances. Compliance with such environmental laws and regulations may require the acquisition of permits or other authorizations for certain activities and compliance with various standards or procedural requirements. We believe that our facilities are in substantial compliance with current regulatory standards. Our operations are also governed by laws and regulations relating to workplace safety and worker health, primarily the Occupational Safety and Health Act and regulations promulgated thereunder. In addition, various other governmental and quasi-governmental agencies require us to obtain certain permits, licenses and certificates with respect to our operations. The kinds of permits, licenses and certificates required by our operations depend upon a number of factors. We believe that we have all material permits, licenses and certificates necessary for the conduct of our existing business.

Our employees may engage in certain activities, including interconnect piping and other service activities conducted on offshore platforms, activities performed on the spud barges owned or chartered by us, marine vessel fabrication and repair activities performed at our facilities, and operating vessels owned by us, that are covered in either the provisions of the Jones Act or U.S. Longshoreman and Harbor Workers Act ("USL&H"). These laws operate to make the liability limits established under state workers' compensation laws inapplicable to these employees and, instead, permit them or their representatives to pursue actions against us for damages or job related injuries, with generally no limitations on our potential liability. Our ownership and operation of vessels and our fabrication and repair of customer vessels can give rise to large and varied liability risks, such as risks of collisions with other vessels or structures, sinkings, fires and other marine casualties, which can result in significant claims for damages against us for, among other things, personal injury, death, property damage, pollution and loss of business.

In addition, our operations are subject to extensive government regulation by the United States Coast Guard, as well as various private industry organizations such as the American Petroleum Institute, American Society of Mechanical Engineers, American Welding Society and the American Bureau of Shipping.

Our compliance with these laws and regulations has entailed certain additional expenses and changes in operating procedures; however, we believe that compliance efforts have not resulted in a material adverse effect on our business or financial condition. However, future events, such as changes in existing laws and regulations or their interpretation, more vigorous enforcement policies of regulatory agencies, or stricter or different interpretations of existing laws and regulations, may require additional expenditures by us, which could potentially adversely impact our future results of operations and financial position.

Insurance

We maintain insurance against property damage caused by fire, flood, explosion and similar catastrophic events that may result in physical damage or destruction to our facilities. All policies are subject to deductibles and other coverage limitations. We also maintain a builder's risk policy for construction projects, general liability insurance and maritime employer's liability insurance, which are also subject to deductibles and coverage limitations. The Company is self-insured for workers' compensation and USL&H claims except for losses in excess of a per occurrence threshold amount. Although management believes that our insurance is adequate, there can be no assurance that we will be able to maintain adequate insurance at rates which management considers commercially reasonable, nor can there be any assurance that such coverage will be adequate to cover all claims that may arise.

Employees

Our workforce varies based on the level of ongoing fabrication activity at any particular time. As of December 31, 2017 and 2016, we had approximately 977 and 1,178 employees, respectively. None of our employees are employed pursuant to a collective bargaining agreement, and we believe our relationship with our employees is good. We have reduced our skilled workforce during 2017 in response to decreases in utilization of our facilities. Our productivity and profitability depends substantially on our ability to attract and retain skilled construction workers, primarily welders, fitters and equipment operators. Reductions made in our labor force may make it more difficult for us to increase our labor force to desirable levels during periods of rapid expanding customer demand. Also, when demand for these workers is high, the supply becomes increasingly limited resulting in increased market rates for these

workers. During periods of high activity in past years, we have enhanced several incentive programs and expanded our training facility in an effort to maintain our current workforce and attract new employees. See also "We might be unable to employ a sufficient number of skilled workers." in "Risk Factors" in Item 1A of this Report on Form 10-K.

Item 1A. Risk Factors

The following discussion of risk factors contains forward-looking statements see "Cautionary Statement on Forward-Looking Information". These risk factors may be important to understanding other statements in this Report on Form 10-K. The following information should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the consolidated financial statements and related notes found elsewhere in this Report on Form 10-K.

Our business, financial condition and operating results can be affected by a number of factors, whether currently known or unknown, including but not limited to those described below, any one or more of which could, directly or indirectly, cause our actual financial condition and operating results to vary materially those anticipated, projected or assumed in the forward-looking statements. Any of these factors, in whole or in part, could materially and adversely affect our business, prospects, financial condition, results of operations, stock price and cash flows. These could also be affected by additional factors that apply to all companies generally which are not specifically mentioned below.

We are subject to the cyclical nature of the oil and gas industry.

Historically, our business has depended significantly on the level of capital expenditures by offshore oil and gas and marine companies in the GOM and along the Gulf Coast. This level of activity has traditionally been volatile, primarily as a result of fluctuations in oil and gas prices. Oil and gas prices declined significantly beginning in the latter half of 2014 and since then, have not increased to a level that supports a recovery in offshore exploration and production spending. In addition to the price of oil and gas, the levels of our customers’ capital expenditures are influenced by, among other things:

- the cost of exploring for, producing and delivering oil and gas;
- the ability of oil and gas companies to generate capital;
- the sale and expiration dates of offshore leases in the United States and overseas;
- the discovery rate of new oil and gas reserves in offshore areas;
- local, federal and international political and economic conditions;
- technological advances; and
- uncertainty regarding the United States energy policy, particularly any revision, reinterpretation or creation of environmental and tax laws and regulations that would negatively impact the industry.

The above factors have not favored increased capital spending by offshore oil and gas companies in recent years. This has created challenges with respect to our ability to operate our fabrication facilities at desired utilization levels throughout 2016 and 2017, resulting in decreased revenue and lower margins. As a result, there are fewer project awards to replace completed projects, and pricing of newer contracts remains increasingly competitive. In addition, we believe that the downturn in the oil and gas industry has also adversely impacted many of our customers' businesses. See also "We depend on significant customers, and we are exposed to the credit risks of our customers, including the nonpayment and nonperformance by our customers."

We are unable to predict future oil and gas prices or the level of oil and gas industry activity in the GOM region. Higher oil and natural gas prices in the future may not necessarily translate into increased activity, and even during periods of relatively high oil prices, our customers may cancel or curtail programs, or reduce their levels of capital expenditures for offshore iv>
)
Net loss per common share:

Basic	$ (0.07)	$ (0.05)	
Diluted	$ (0.07)	$ (0.05)	
Weighted-average number of common shares outstanding:			
Basic	22,927,000	22,641,000	
Diluted	22,927,000	22,641,000	

See notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2015	2014
Net loss	$(1,654)	$(1,086)
Other comprehensive loss:		
Foreign currency translation adjustments	(161)	(509)
Unrealized gains from marketable securities, net of tax	—	28
Total other comprehensive loss	(161)	(481)
Comprehensive loss	$(1,815)	$(1,567)

See notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2015	2014
Operating Activities		
Net loss	$(1,654)	$(1,086)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	520	493
Amortization	543	196
Gain on disposal of equipment	(25)	—
Allowance for doubtful accounts	10	85
Deferred income taxes	(226)	305
Stock-based compensation	272	424
Changes in operating assets and liabilities:		
Accounts receivable	4,882	1,059
Inventories	(536)	(474)
Prepaid expenses, other current assets and other non-current assets	(35)	(446)
Accounts payable	(937)	(409)
Accrued liabilities and other non-current liabilities	(1,699)	(1,988)
Net cash provided by (used in) operating activities	1,115	(1,841)
Investing Activities		
Purchases of property, equipment and patents	(276)	(322)
Proceeds from the sale of equipment	25	—
Net cash used in investing activities	(251)	(322)
Financing Activities		
Payments on short-term borrowings	(815)	—
Proceeds from exercises of stock options	—	160
Excess tax benefit from exercises of stock options	—	12
Treasury shares withheld	(173)	(261)
Net cash used in financing activities	(988)	(89)
Effect of exchange rate fluctuations on cash	(203)	(568)
Net decrease in cash and cash equivalents	(327)	(2,820)
Cash and cash equivalents at beginning of period	18,637	27,738
Cash and cash equivalents at end of period	$18,310	$24,918

See notes to condensed consolidated financial statements.

FUEL TECH, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2015
(Unaudited)
(in thousands, except share and per-share data)

Note A: Nature of Business

Fuel Tech, Inc. (Fuel Tech or the Company or "we", "us", or "our") is a fully integrated company that uses a suite of advanced technologies to provide boiler optimization, efficiency improvement and air pollution reduction and control solutions to utility and industrial customers worldwide. Originally incorporated in 1987 under the laws of the Netherlands Antilles as Fuel-Tech N.V., Fuel Tech became domesticated in the United States on September 30, 2006, and continues as a Delaware corporation with its corporate headquarters at 27601 Bella Vista Parkway, Warrenville, Illinois, 60555-1617. Fuel Tech maintains an Internet website at www.ftek.com. Fuel Tech's Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934 as amended (Exchange Act), are made available through our website as soon as reasonably practical after electronically filed or furnished to the Securities and Exchange Commission. Also available on Fuel Tech's website are the Company's Corporate Governance Guidelines and Code of Ethics and Business Conduct, as well as the charters of the Audit, Compensation, and Nominating and Corporate Governance committees of the Board of Directors. All of these documents are available in print without charge to stockholders who request them. Information on our website is not incorporated into this report.
Fuel Tech's special focus is the worldwide marketing of its nitrogen oxide (NOx) reduction and FUEL CHEM® processes. The Air Pollution Control (APC) technology segment reduces NOx emissions in flue gas from boilers, incinerators, furnaces and other stationary combustion sources by utilizing combustion optimization techniques and Low NOx and Ultra Low NOx Burners; Over-Fire Air systems, NOxOUT® and HERT™ High Energy Reagent Technology™ SNCR systems; systems that incorporate ASCR™ (Advanced Selective Catalytic Reduction) technologies including NOxOUT-CASCADE®, ULTRA™ and NOxOUT-SCR® processes, Ammonia Injection Grid (AIG) and Graduated Straightening Grid (GSG™), as well as Electrostatic Precipitator rebuilds and Flue Gas Conditioning systems to control particulate emissions. The FUEL CHEM® technology segment improves the efficiency, reliability and environmental status of combustion units by controlling slagging, fouling and corrosion, as well as the formation of sulfur trioxide, ammonium bisulfate, particulate matter (PM2.5), carbon dioxide, NOx and unburned carbon in fly ash through the addition of chemicals into the fuel or via TIFI® Targeted In-Furnace Injection™ programs. Fuel Tech has other technologies, both commercially available and in the development stage, all of which are related to APC and FUEL CHEM technology segments or are similar in their technological base. We have expended significant resources in the research and development of new technologies in building our proprietary portfolio of products and services.
Fuel Tech's business is materially dependent on the continued existence and enforcement of worldwide air quality regulations.

Note B: Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Exchange Act. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the balance sheet and results of operations for the periods covered have been included and all significant intercompany transactions and balances have been eliminated. The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the results to be expected for the full year.
The balance sheet at December 31, 2014 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in Fuel Tech's Annual Report on Form 10-K for the year ended December 31, 2014 as filed with the Securities and Exchange Commission.

Note C: Revenue Recognition Policy

Revenues from the sales of chemical products are recorded when title transfers, either at the point of shipment or at the point of destination, depending on the contract with the customer.

Fuel Tech uses the percentage of completion method of accounting for equipment construction and license contracts that are sold within the Air Pollution Control technology segment. Under the percentage of completion method, revenues are recognized as work is performed based on the relationship between actual construction costs incurred and total estimated costs at completion. Construction costs include all direct costs such as materials, labor, and subcontracting costs, and indirect costs allocable to the particular contract such as indirect labor, tools and equipment, and supplies. Revisions in completion estimates and contract values

are made in the period in which the facts giving rise to the revisions become known and can influence the timing of when revenues are recognized under the percentage of completion method of accounting. Such revisions have historically not had a material effect on the amount of revenue recognized. The completed contract method is used for certain contracts that are not long-term in nature or when reasonably dependable estimates of the percentage of completion cannot be made. When the completed contract method is used, revenue and costs are deferred until the contract is substantially complete, which usually occurs upon customer acceptance of the installed product. Provisions are made for estimated losses on uncompleted contracts in the period in which such losses are determined. As of March 31, 2015 and December 31, 2014, the Company had one contract in progress that was identified as a loss contract and a provision for loss in the amount of $5 and $4, respectively, was recorded in other accrued liabilities on the consolidated balance sheets.

Fuel Tech's APC contracts are typically eight to sixteen months in length. A typical contract will have three or four critical operational measurements that, when achieved, serve as the basis for us to invoice the customer via progress billings. At a minimum, these measurements will include the generation of engineering drawings, the shipment of equipment and the completion of a system performance test.

As part of most of its contractual APC project agreements, Fuel Tech will agree to customer-specific acceptance criteria that relate to the operational performance of the system that is being sold. These criteria are determined based on mathematical modeling that is performed by Fuel Tech personnel, which is based on operational inputs that are provided by the customer. The customer will warrant that these operational inputs are accurate as they are specified in the binding contractual agreement. Further, the customer is solely responsible for the accuracy of the operating condition information; typically all performance guarantees and equipment warranties granted by us are voidable if the operating condition information is inaccurate or is not met.

Accounts receivable includes unbilled receivables, representing revenues recognized in excess of billings on uncompleted contracts under the percentage of completion method of accounting. At March 31, 2015 and December 31, 2014, unbilled receivables were approximately $9,836 and $9,904, respectively, and are included in accounts receivable on the consolidated balance sheets. Billings in excess of costs and estimated earnings on uncompleted contracts were $2,792 and $2,994, at March 31, 2015 and December 31, 2014, respectively. Such amounts are included in other accrued liabilities on the consolidated balance sheets.

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.

Note D: Cost of Sales

Cost of sales includes all internal and external engineering costs, equipment and chemical charges, inbound and outbound freight expenses, internal and site transfer costs, installation charges, purchasing and receiving costs, inspection costs, warehousing costs, project personnel travel expenses and other direct and indirect expenses specifically identified as project- or product line-related, as appropriate (e.g., test equipment depreciation and certain insurance expenses). Certain depreciation and amortization expenses related to tangible and intangible assets, respectively, are also allocated to cost of sales.

Note E: Selling, General and Administrative Expenses

Selling, general and administrative expenses primarily include the following categories except where an allocation to the cost of sales line item is warranted due to the project- or product-line nature of a portion of the expense category: salaries and wages, employee benefits, non-project travel, insurance, legal, rent, accounting and auditing, recruiting, telephony, employee training, Board of Directors' fees, auto rental, office supplies, dues and subscriptions, utilities, real estate taxes, commissions and bonuses, marketing materials, postage and business taxes. Departments comprising the selling, general and administrative line item primarily include the functions of executive management, finance and accounting, investor relations, regulatory affairs, marketing, business development, information technology, human

resources, sales, legal and general administration.

Note F: Available-for-Sale Marketable Securities

At the time of purchase, marketable securities are classified as available-for-sale as management has the intent and ability to hold such securities for an indefinite period of time, but not necessarily to maturity. Any decision to sell available-for-sale securities would be based on various factors, including, but not limited to asset/liability management strategies, changes in interest rates or prepayment risks, and liquidity needs. Available-for-sale securities are carried at fair value with unrealized gains and losses, net of related deferred income taxes, recorded in equity as a separate component of other comprehensive income (OCI). Our marketable securities consist of a single equity investment with a fair value of $36 and $36 and no cost basis at March 31, 2015 and December 31, 2014, respectively. Purchases and sales of securities are recognized on a trade date basis. Realized securities gains or losses are reported in other income/(expense) in the Consolidated Statements of Operations. The cost of securities sold is based on the specific identification

method. On a quarterly basis, we make an assessment to determine if there have been any events or circumstances to indicate whether a security with an unrealized loss is impaired on an other-than-temporary (OTTI) basis. This determination requires significant judgment. OTTI is considered to have occurred (1) if management intends to sell the security; (2) if it is more likely than not we will be required to sell the security before recovery of its amortized cost basis; or (3)the present value of the expected cash flows is not sufficient to recover the entire amortized cost basis. The credit-related OTTI, represented by the expected loss in principal, is recognized in non-interest income, while noncredit-related OTTI is recognized in OCI. For securities which we do expect to sell, all OTTI is recognized in earnings. Presentation of OTTI is made in the income statement on a gross basis with a reduction for the amount of OTTI recognized in OCI. Once an other-than-temporary impairment is recorded, when future cash flows can be reasonably estimated, future cash flows are re-allocated between interest and principal cash flows to provide for a level-yield on the security. We have not experienced any other-than-temporary impairments during the periods ended March 31, 2015 and 2014.

Note G: Accumulated Other Comprehensive Loss

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

	Three Months Ended March 31,	
	2015	2014
Foreign currency translation		
Balance at beginning of period	$(471)	$18
Other comprehensive loss:		
Foreign currency translation adjustments (1)	(161)	(509)
Balance at end of period	$(632)	$(491)
Available-for-sale marketable securities		
Balance at beginning of period	$23	$19
Other comprehensive income:		
Net unrealized holding gain (2)	—	46
Deferred income taxes (2)	—	(18)
Total other comprehensive income	—	28
Balance at end of period	$23	$47
Total accumulated other comprehensive loss	$(609)	$(444)

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

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

Note H: Treasury Stock

Common stock held in treasury totaled 222,378 and 167,306 with a cost of $963 and $790 at March 31, 2015 and December 31, 2014, 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 since 2012.

Note I: Earnings per Share Data

Basic earnings per share excludes the dilutive effects of stock options, restricted stock units (RSUs), and the nil coupon non-redeemable convertible unsecured loan notes. Diluted earnings per share includes the dilutive effect of the nil coupon non-redeemable convertible unsecured loan notes, RSUs, and unexercised in-the-money stock options, except in periods of net loss where the effect of these instruments is anti-dilutive. Out-of-money stock options are excluded from diluted earnings per share because they are anti-dilutive. For the three months ended March 31, 2015 and 2014, basic earnings per share is equal to diluted earnings per share because all outstanding stock awards and

convertible loan notes are considered anti-dilutive during periods of net loss. The following table sets forth the weighted-average shares used in calculating the earnings per share for the three month periods ended March 31, 2015 and 2014.

	Three Months Ended March 31,	
	2015	2014
Basic weighted-average shares	22,927,000	22,641,000
Conversion of unsecured loan notes	—	—
Unexercised options and unvested RSUs	—	—
Diluted weighted-average shares	22,927,000	22,641,000

Fuel Tech had 1,851,000 and 2,458,000 weighted average equity awards outstanding at March 31, 2015 and 2014, respectively, that were not dilutive for the purposes of inclusion in the calculation of diluted earnings per share but could potentially become dilutive in future periods.

Note J: Stock-Based Compensation

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

The 2014 Plan permits grants of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards (in the form of equity or cash bonuses), dividend equivalents on full value awards and other awards (which may be based in whole or in part on the value of our common stock or other property). Directors, salaried employees, and consultants of Fuel Tech and its commonly-controlled affiliates are eligible to participate in the 2014 Plan. The number of shares originally reserved for share-based awards under the 2014 Plan equaled 2,000,000 shares, less the number of share-based awards made under the FTIP between December 31, 2013 and the effective date of the 2014 Plan. As of March 31, 2015, Fuel Tech had 1,234,389 shares available for share-based awards under the 2014 Plan.

Stock-based compensation is included in selling, general, and administrative costs in our Consolidated Statements of Operations. The components of stock-based compensation for the three month periods ended March 31, 2015 and 2014 were as follows:

	Three Months Ended March 31,	
	2015	2014
Stock options and restricted stock units	$272	$424
Tax benefit of stock-based compensation expense	(103)	(163)
After-tax effect of stock-based compensation	$169	$261

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 three months ended March 31, 2015 was as follows:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding on January 1, 2015	1,546,500	$11.62		
Granted	—	—		
Exercised	—	—		
Expired or forfeited	(5,000)	6.51		
Outstanding on March 31, 2015	1,541,500	$11.63	3.23	$—
Exercisable on March 31, 2015	1,541,500	$11.63	3.23	$—

As of March 31, 2015, 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 three year period in equal installments). Such time-vested RSUs are valued at fair value based on the closing price on the date of grant. Compensation cost, adjusted for estimated forfeitures, is amortized on a straight-line basis over the requisite service period.

In addition to the time vested RSUs described above, commencing in 2011, on an annual basis the Company entered into performance-based RSU agreements (the Agreements) with each of the Company's President/Chief Executive Officer, Treasurer/Chief Financial Officer, Executive Vice President of Marketing & Sales, and Executive Vice President and Chief Operating Officer. Commencing in 2013, the Company's Senior Vice President, General Counsel, and Secretary also entered into an agreement. The Agreements provide each participating executive the opportunity to earn three types of awards with each award type specifying a targeted number of RSUs that may be granted to each executive based on either the individual performance of the executive or the Company's relative performance compared to a peer group, as determined by the award type. The Compensation Committee of our Board of Directors (the Committee) determines the extent to which, if any, RSUs will be granted based on the achievement of the applicable performance criteria specified in the Agreement. This determination will be made following the completion of the applicable performance period (each a Determination Date). Such performance based awards include the following:

- The first type of award is based on individual performance during the respective calendar year as determined by the Committee based on performance criteria specified in the Agreement. These awards will vest over a three year period beginning on the Determination Date. We estimated the fair value of these performance-based RSU awards on the date of the Agreement using the trading price of the Company's stock and our estimate of the probability that the specified performance criteria will be met. The fair value measurement and probability estimate will be re-measured each reporting date until the Determination Date, at which time the final award amount will be known. For these job performance-based awards, we amortize compensation costs over the requisite service period, adjusted for estimated forfeitures, for each separately vesting tranche of the award.
- The second type of RSU award contains a targeted number of RSUs to be granted based on the Company's revenue growth relative to a specified peer group during a period of two calendar years. These awards vest 67% on the second anniversary of the Agreement date and 33% on the third anniversary of the Agreement date. We estimated the fair value of these performance-based RSU awards on the Agreement date using the trading price of the Company's stock on the date of determination and our estimate of the probability that the specified performance criteria will be met. For these revenue growth performance-based awards, we amortize compensation costs over the requisite service period, adjusted for estimated forfeitures, for each separately vesting tranche of the award.
- The third type of RSU award contains a targeted number of RSUs to be granted based on the total shareholder return (TSR) of the Company's common stock relative to a specified peer group during a period of two calendar years. These awards vest 67% on the second anniversary of the Agreement date and 33% on the third anniversary of the Agreement

date. We estimated the fair value of these market-based RSU awards on the Agreement date using a Monte Carlo valuation methodology and amortize the fair value over the requisite service period for each separately vesting tranche of the award. The principal variable assumptions utilized in valuing these RSUs under this valuation methodology include the risk-free interest rate, stock volatility, and correlations between our stock price and the stock prices of a peer group of companies.

At March 31, 2015, there is $3,018 of unrecognized compensation costs related to restricted stock unit awards to be recognized over a weighted average period of 2.33 years.

A summary of restricted stock unit activity for the three months ended March 31, 2015 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested restricted stock units at January 1, 2015	977,069	$ 5.36
Granted	336,000	3.37
Forfeited	(180,000)	4.67
Vested	(220,470)	5.06
Unvested restricted stock units at March 31, 2015	912,599	$ 4.84

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 three-month periods ended March 31, 2015 and 2014, Fuel Tech recorded no stock-based compensation expense under the Deferred Plan.

Note K: Debt

On June 30, 2013, Fuel Tech amended its existing revolving credit facility (the Facility) with JPMorgan Chase Bank, N.A (JPM Chase) to extend the maturity date through June 30, 2015. The Company intends to renew this credit facility upon its expiration. The total borrowing base of the facility is $15,000 and contains a provision to increase the facility up to a total principal amount of $25,000 upon approval from JPM Chase. The Facility is unsecured, bears interest at a rate of LIBOR plus a spread range of 250 basis points to 375 basis points, as determined by a formula related to the Company's leverage ratio, and has the Company's Italian subsidiary, Fuel Tech S.r.l., as a guarantor. Fuel Tech can use this Facility for cash advances and standby letters of credit. As of March 31, 2015 and December 31, 2014, there were no outstanding borrowings on the credit facility.

The Facility contains several debt covenants with which the Company must comply on a quarterly or annual basis, including a maximum Funded Debt to EBITDA Ratio (or "Leverage Ratio", as defined in the Facility) of 2.0:1.0 based on the four trailing quarterly periods. Maximum funded debt is defined as all borrowed funds, outstanding standby letters of credit and bank guarantees. EBITDA includes after tax earnings with add backs for interest expense, income taxes, depreciation and amortization, and stock-based compensation expenses. This covenant was waived by our bank through the maturity date of the credit facility. In addition, the Facility covenants include an annual capital expenditure limit of $10,000 and a minimum tangible net worth of $50,000.

At March 31, 2015 and December 31, 2014, the Company had outstanding standby letters of credit and bank guarantees totaling approximately $6,969 and $8,284, respectively, on its domestic credit facility in connection with contracts in process. Fuel Tech is committed to reimbursing the issuing bank for any payments made by the bank under these instruments. At March 31, 2015 and December 31, 2014, there were no cash borrowings under the domestic revolving credit facility and approximately $8,031 and $6,716, respectively, was available for future borrowings. The Company pays a commitment fee of 0.25% per year on the unused portion of the revolving credit facility.

On June 27, 2014, Beijing Fuel Tech Environmental Technologies Company, Ltd. (Beijing Fuel Tech), a wholly-owned subsidiary of Fuel Tech, entered into a new revolving credit facility (the China Facility) agreement with JPM Chase for RMB 35 million (approximately $5,729), which expires on June 26, 2015. The Company intends to renew this credit facility upon its expiration. This credit facility replaced the previous RMB 35 million facility that expired on June 27, 2014. The facility is unsecured, bears interest at a rate of 125% of the People's Bank of China (PBOC) Base Rate, and is guaranteed by Fuel Tech. Beijing Fuel Tech can use this facility for cash advances and bank guarantees. As of March 31, 2015 and December 31, 2014, Beijing Fuel Tech has borrowings outstanding in the amount of $818 and $1,625, respectively. These borrowings were subject to interest rates of approximately 7.0% at March 31, 2015 and December 31, 2014, respectively.

At March 31, 2015 and December 31, 2014, the Company had outstanding standby letters of credit and bank guarantees totaling approximately $197 and $336, respectively, on its Beijing Fuel Tech revolving credit facility in

connection with contracts in process. At March 31, 2015 and December 31, 2014, approximately $4,714 and $3,727 was available for future borrowings.

In the event of default on either the domestic facility or the China facility, the cross default feature in each allows the lending bank to accelerate the payments of any amounts outstanding and may, under certain circumstances, allow the bank to cancel the facility. If the Company were unable to obtain a waiver for a breach of covenant and the bank accelerated the payment of any outstanding amounts, such acceleration may cause the Company's cash position to deteriorate or, if cash on hand were insufficient to satisfy the payment due, may require the Company to obtain alternate financing to satisfy the accelerated payment.

Interest payments in the amount of $27 and $29 were made during the three-month periods ended March 31, 2015 and 2014.

Note L: Business Segment and Geographic Disclosures

Fuel Tech segregates its financial results into two reportable segments representing two broad technology segments as follows:

- The Air Pollution Control technology segment includes technologies to reduce NOx emissions in flue gas from boilers, incinerators, furnaces and other stationary combustion sources. These include Low and Ultra Low NOx Burners (LNB and ULNB), Over-Fire Air (OFA) systems, NOxOUT® and HERT™ Selective Non-Catalytic Reduction (SNCR) systems, and Advanced Selective Catalytic Reduction (ASCR™) systems. The ASCR system includes ULNB, OFA, and SNCR components, along with a downsized SCR catalyst, Ammonia Injection Grid (AIG), and Graduated Straightening Grid (GSG™) systems to provide high NOx reductions at significantly lower capital and operating costs than conventional SCR systems. The NOxOUT CASCADE® and NOxOUT-SCR® processes are basic types of ASCR systems, using just SNCR and SCR catalyst components. ULTRA™ technology creates ammonia at a plant site using safe urea for use with any SCR application. Also included in this technology segment are Electrostatic Precipitator (ESP) rebuilds and retrofits and Flue Gas Conditioning systems, which are chemical injection systems used to enhance ESP and fabric filter performance in controlling particulate emissions.
- The FUEL CHEM® technology segment, which uses chemical processes in combination with advanced Computational Fluid Dynamics (CFD) and Chemical Kinetics Modeling (CKM) boiler modeling, for the control of slagging, fouling, corrosion, opacity and other sulfur trioxide-related issues in furnaces and boilers through the addition of chemicals into the furnace using TIFI® Targeted In-Furnace Injection™ technology.

The “Other” classification includes those profit and loss items not allocated by Fuel Tech to each reportable segment. Further, there are no intersegment sales that require elimination.

Fuel Tech evaluates performance and allocates resources based on reviewing gross margin by reportable segment. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies (Note 1 in our annual report on Form 10-K). Fuel Tech does not review assets by reportable segment, but rather, in aggregate for Fuel Tech as a whole.

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

Three months ended March 31, 2015	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Revenues from external customers	$ 6,857	$8,246	$—	$15,103
Cost of sales	(4,321)	(4,116)	—	(8,437)
Gross margin	2,536	4,130	—	6,666
Selling, general and administrative	—	—	(8,203)	(8,203)
Research and development	—	—	(872)	(872)
Operating income (loss)	$ 2,536	$4,130	$(9,075)	$(2,409)

Three months ended March 31, 2014	Air Pollution Control Segment	FUEL CHEM Segment	Other	Total
Revenues from external customers	$ 10,734	$7,927	$—	$18,661
Cost of sales	(7,030)	(3,780)	—	(10,810)
Gross margin	3,704	4,147	—	7,851
Selling, general and administrative	—	—	(8,744)	(8,744)
Research and development	—	—	(244)	(244)
Operating income (loss)	$ 3,704	$4,147	$(8,988)	$(1,137)

Information concerning Fuel Tech's operations by geographic area is provided below. Revenues are attributed to countries based on the location of the customer. Assets are those directly associated with operations of the geographic area.

	Three Months Ended March 31,	
	2015	2014
Revenues:		
United States	$12,575	$9,229
Foreign	2,528	9,432
	$15,103	$18,661
	March 31, 2015	December 31, 2014
Assets:		
United States	$59,176	$64,324
Foreign	27,287	27,147
	$86,463	$91,471

Note M: Contingencies

Fuel Tech issues a standard product warranty with the sale of its products to customers. Our recognition of warranty liability is based primarily on analyses of warranty claims experienced in the preceding years as the nature of our historical product sales for which we offer a warranty are substantially unchanged. This approach provides an aggregate warranty accrual that is historically aligned with actual warranty claims experienced.

Changes in the warranty liability for the three months March 31, 2015, and 2014, are summarized below:

	Three Months Ended March 31,	
	2015	2014
Aggregate product warranty liability at beginning of period	$268	$596
Net aggregate expense (benefit) related to product warranties	2	(50)
Aggregate reductions for payments	(2)	(14)
Aggregate product warranty liability at end of period	$268	$532

Note N: Income Taxes

The Company's effective tax rate of 35% and 8% for the three-month periods ended March 31, 2015 and 2014, respectively, differs from the statutory federal tax rate of 34% due primarily to state taxes, differences between U.S. and foreign tax rates, foreign losses incurred with no related tax benefit, non-deductible commissions, and non-deductible meals and entertainment expenses.

Fuel Tech had unrecognized tax benefits as of March 31, 2015 and December 31, 2014 in the amount of $117, respectively, all of which, if ultimately recognized, will reduce Fuel Tech's annual effective tax rate.

Note O: Goodwill and Other Intangibles

Goodwill is allocated among and evaluated for impairment at the reporting unit level, which is defined as an operating segment or one level below an operating segment. Fuel Tech has two reporting units which are reported in the FUEL CHEM® technology segment and the APC technology segment. At both March 31, 2015 and December 31, 2014 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 three months ended March 31, 2015 and 2014.

Fuel Tech reviews other intangible assets, which include customer lists and relationships, covenants not to compete, patent assets, tradenames, and acquired technologies, for impairment on a recurring basis or when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. In the event that impairment indicators exist, a further analysis is performed and if the sum of the expected undiscounted future cash flows resulting from the use of the asset is less than the carrying amount of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. Management considers historical experience and all available information at the time the estimates of future cash flows are made, however, the actual cash values that could be realized may differ from those that are estimated. There were no indications of intangible asset impairment in the three-month periods ended March 31, 2015 and 2014.

Note P: Fair Value

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

- Level 1 – Observable inputs to the valuation methodology such as quoted prices in active markets for identical assets or liabilities
- Level 2 – Inputs to the valuation methodology including quoted prices for similar assets or liabilities in active markets, quoted prices for identical assets of liabilities in inactive markets, inputs other than quoted prices that are observable for the asset or liability, and inputs that are derived principally from or corroborated by observable market data by

correlation or other means

- Level 3 – Significant unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own estimates and assumptions or those expected to be used by market participants. Generally, these fair value measures are model-based valuation techniques such as discounted cash flows, option pricing models, and other commonly used valuation techniques

The fair value of our marketable securities was $36 and $36 at March 31, 2015 and December 31, 2014, respectively, and was determined using quoted prices in active markets for identical assets (Level 1 fair value measurements). Transfers between levels of the fair value hierarchy are recognized based on the actual date of the event or change in circumstances that caused the transfer. We had no assets or liabilities that were valued using level 2 or level 3 inputs and therefore there were no transfers between levels of the fair value hierarchy during the three-month periods ended March 31, 2015 and 2014.
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.

FUEL TECH, INC.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
Results of Operations
Revenues for the three-months ended March 31, 2015 and 2014 were $15,103 and $18,661,respectively, representing a current year decrease of $3,558 or 19%.
The Air Pollution Control (APC) technology segment generated revenues of $6,857 for the three-months ending March 31, 2015, a decrease of $3,877 or 36% from the prior year amount of $10,734. The decline in APC revenue was principally related to a year-over-year decrease of $3.4 million from a large international burner project.
Consolidated APC backlog at March 31, 2015 was $16,033 versus backlog at December 31, 2014 of $17,965. Our current backlog consists of US domestic projects totaling $10,362 and international projects totaling $5,671.
The FUEL CHEM® technology segment generated revenues of $8,246 for the three-months ended March 31, 2015, representing an increase of $319 or 4% from the prior year amount of $7,927. 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-months ended March 31, 2015 was 44%, up 2% from the prior year percentage of 42%. The gross margin percentage for the APC technology segment for the current quarter was 37%, up 2% from the prior year percentage of 35%. For the FUEL CHEM technology segment, the gross margin percentage for the current quarter decreased slightly to 50% from 52% in the prior year.

Selling, general and administrative expenses (SG&A) for the three months ended March 31, 2015 was $8,203, which represents a decrease of $541 from the prior year amount of $8,744. This change resulted from a decrease in employee related costs including stock-based compensation of $80, administrative costs associated with our foreign operations of $312, travel expenses of $205, and professional and consulting fees of $135, offset by an increase in marketing costs of $136. SG&A as a percentage of revenues increased to 54% in the current year from 47% in the prior year due to the decline in current year revenue.

Research and development expenses for the three months ended March 31, 2015 was $872, representing an increase of $628 over the prior year amount of $244. We plan to continue funding research projects in pursuit of new commercial applications for technologies outside of our traditional markets and in the development and analysis of new technologies that could represent incremental market opportunities.

Interest expense for the three months ended March 31, 2015 and 2014 were $27 and $29, respectively. This interest expense relates to borrowings made under the Beijing Fuel Tech credit facility.

Income tax benefit for the three months ended ended March 31, 2015 and 2014 were $871 and $99, respectively. The Company is projecting a consolidated effective tax rate of 35% for 2015 which is slightly higher than the federal income tax rate of 34% due to the effect of state income taxes, federal income tax credits and other permanent items including losses in foreign jurisdictions for which we do not anticipate a tax benefit.

Liquidity and Sources of Capital

At March 31, 2015, Fuel Tech had cash and cash equivalents and short-term investments on hand of $18,346 and working capital of $38,889 versus $18,673 and $39,688 at December 31, 2014, respectively.

Operating activities provided cash of $1,115 during the three months ended March 31, 2015. This increase in cash from operations was due to a decrease in accounts receivable of $4,882 and non-cash expenses of $1,094, offset by cash used as a result of our net

loss of $1,654, an increase in inventories and prepaid expenses of $571 and a decrease in the outstanding accounts payable and accrued liabilities balances of $2,636.

Investing activities used cash of $251 during the three months ended March 31, 2015 and related to net cash used for purchases of equipment and patents of $276 offset by proceeds from the sales of equipment of $25.

Financing activities used cash of $988 during the three months ended March 31, 2015 as a result of $173 in cash used for the acquisition of common shares held in treasury that were withheld for taxes due by employees upon lapsing of restricted stock units and $815 for payments made on short-term borrowings.

On June 30, 2013, Fuel Tech amended its existing revolving credit facility (the Facility) with JPMorgan Chase Bank, N.A (JPM Chase) to extend the maturity date through June 30, 2015. The total borrowing base of the facility is $15,000 and contains a provision to increase the facility up to a total principal amount of $25,000 upon approval from JPM Chase. The Facility is unsecured, bears interest at a rate of LIBOR plus a spread range of 250 basis points to 375 basis points, as determined by a formula related to the Company's leverage ratio, and has the Company's Italian subsidiary, Fuel Tech S.r.l., as a guarantor. Fuel Tech can use this Facility for cash advances and standby letters of credit. As of March 31, 2015 and December 31, 2014, there were no outstanding borrowings on the credit facility. The Facility contains several debt covenants with which the Company must comply on a quarterly or annual basis, including a maximum Funded Debt to EBITDA Ratio (or "Leverage Ratio", as defined in the Facility) of 2.0:1.0 based on the four trailing quarterly periods. Maximum funded debt is defined as all borrowed funds, outstanding standby letters of credit and bank guarantees. EBITDA includes after tax earnings with add backs for interest expense, income taxes, depreciation and amortization, and stock-based compensation expenses. This covenant was waived by our bank through the maturity date of the credit facility. In addition, the Facility covenants include an annual capital expenditure limit of $10,000 and a minimum tangible net worth of $50,000. At March 31, 2015, the Company was in compliance with all active financial covenants specified by the Facility.

At March 31, 2015 and December 31, 2014, the Company had outstanding standby letters of credit and bank guarantees totaling approximately $6,969 and $8,284, respectively, on its domestic credit facility in connection with contracts in process. Fuel Tech is committed to reimbursing the issuing bank for any payments made by the bank under these instruments. At March 31, 2015 and December 31, 2014, there were no cash borrowings under the domestic revolving credit facility and approximately $8,031 and $6,716, respectively, was available for future borrowings. The Company pays a commitment fee of 0.25% per year on the unused portion of the revolving credit facility.

On June 27, 2014, Beijing Fuel Tech Environmental Technologies Company, Ltd. (Beijing Fuel Tech), a wholly-owned subsidiary of Fuel Tech, entered into a new revolving credit facility (the China Facility) agreement with JPM Chase for RMB 35 million (approximately $5,729), which expires on June 26, 2015. This credit facility replaced the previous RMB 35 million facility that expired on June 27, 2014. The facility is unsecured, bears interest at a rate of 125% of the People's Bank of China (PBOC) Base Rate, and is guaranteed by Fuel Tech. Beijing Fuel Tech can use this facility for cash advances and bank guarantees. As of March 31, 2015 and December 31, 2014, Beijing Fuel Tech has borrowings outstanding in the amount of $818 and $1,625, respectively. These borrowings were subject to interest rates of approximately 7.0% at March 31, 2015 and December 31, 2014, respectively.

At March 31, 2015 and December 31, 2014, the Company had outstanding standby letters of credit and bank guarantees totaling approximately $197 and $336, respectively, on its Beijing Fuel Tech revolving credit facility in connection with contracts in process. At March 31, 2015 and December 31, 2014, approximately $4,714 and $3,727 was available for future borrowings.

In the event of default on either the domestic facility or the China facility, the cross default feature in each allows the lending bank to accelerate the payments of any amounts outstanding and may, under certain circumstances, allow the bank to cancel the facility. If the Company were unable to obtain a waiver for a breach of covenant and the bank accelerated the payment of any outstanding amounts, such acceleration may cause the Company's cash position to deteriorate or, if cash on hand were insufficient to satisfy the payment due, may require the Company to obtain

alternate financing to satisfy the accelerated payment.

Contingencies and Contractual Obligations

Fuel Tech issues a standard product warranty with the sale of its products to customers as discussed in Note M. The warranty liability balance during the three-months ended March 31, 2015 remained constant at $268 compared to the prior year.

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 identifyi 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, 2014 in Item 1A under the caption “Risk Factors,” which could cause Fuel Tech’s actual growth, results of operations, financial condition, cash flows, performance and business prospects and opportunities to differ materially from those expressed in, or implied by, these statements. Fuel Tech undertakes no obligation to update such factors or to publicly announce the results of any of the forward-looking statements contained herein to reflect future events, developments, or changed circumstances or for any other reason. Investors are cautioned that all forward-looking statements involve risks and uncertainties, including those detailed in Fuel Tech’s filings with the Securities and Exchange Commission.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Risk Management

Fuel Tech’s earnings and cash flow are subject to fluctuations due to changes in foreign currency exchange rates. We do not enter into foreign currency forward contracts nor into foreign currency option contracts to manage this risk due to the immaterial nature of the transactions involved.

Fuel Tech is also exposed to changes in interest rates primarily due to its debt facilities (refer to Note K to the consolidated financial statements). A hypothetical 100 basis point adverse move in interest rates along the entire interest rate yield curve would not have a materially adverse effect on interest expense during the upcoming year ended December 31, 2015.

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, 2014 have not materially changed.

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

None

Item 6. Exhibits

a. Exhibits (all filed herewith)

10.1	2015 Executive Officer Incentive Plan of Fuel Tech, Inc.
10.2	Fuel Tech, Inc. Form of 2014 Long-Term Incentive Plan Stock Option Agreement
10.3	Fuel Tech, Inc. Form of 2015 Executive Performance RSU Award Agreement
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: May 11, 2015	By: /s/ Vincent J. Arnone Vincent J. Arnone President and Chief Executive Officer (Principal Executive Officer)
Date: May 11, 2015	By: /s/ David S. Collins David S. Collins Senior Vice President and Chief Financial Officer (Principal Financial Officer)