

# THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

## FuelCell Energy, Inc. (FCEL)



**CHIP BOTTONE** joined FuelCell Energy, Inc., in February 2010 as Senior Vice President and Chief Commercial Officer, and was promoted to President and Chief Executive Officer in February 2011. Before joining FuelCell Energy, he was President of the energy systems business at Ingersoll-Rand Plc. Mr. Bottone's focus is to accelerate revenue growth and profitability by capitalizing on heightened demand by the world's industrialized and emerging nations for clean and renewable energy. He is responsible for developing and implementing strategies to further expand the company's market opportunities and growth potential. Mr. Bottone's qualifications include 25 years of experience at Ingersoll-Rand, a diversified global industrial concern. He received an undergraduate degree in mechanical engineering from the Georgia Institute of Technology in 1983, and received a Certificate of Professional Development from The Wharton School at the University of Pennsylvania in 2004. Mr. Bottone has extensive experience in global commercialization activities that deliver profitable growth.

### SECTOR — ENERGY & UTILITIES

**TWST:** Please start with a brief history of FuelCell Energy as well as an overview of your current products and operations today.

**Mr. Bottone:** We are a fully integrated fuel cell company providing ultraclean and efficient baseload power plants. What that means is we design the core technology, manufacture the fuel cells, provide applications support, do installation work in some cases, and then we have long-term service agreements for our megawatt-class stationary power plants globally. And we actually operate these plants for our clients. They don't actually control the plants. Here in Danbury we have a control center that's manned 24/7 that runs these plants around the world. We have plants in Korea, in the U.S., etc., and we run these plants, load them up, turn them down, whatever. We are pretty unique in that regard.

The reasons customers purchase the fuel cell power plants that we make is, number one, they are efficient. The idea there is if you have limited resources, whether it's clean natural gas or renewable biogas, it's best to get the most out of what you have. Our fuel cell power plants are ultraclean, so you can basically put them anywhere. This is especially valued by customers in regions with strict air permitting regulations as there are virtually no pollutants at all and areas of high population density. You put your head over the stack because that's hot, but that's about the only issue there. What that also translates to is, if you see our plants on a city street, the noise from the taxi cabs that you hear in New York would be louder than the fuel cell.

Our focus is the megawatt-class including 1.4 MW and 2.8 MW power plants that are scalable. The largest fuel cell project in the world is 11.2 MW using four of our largest plants. One fuel cell as big as 1.5 megawatts would be able to power about probably 800 homes, give or take, depending on where you are.

A lot of people ask what kind of power generation process is used by a fuel cell. It's an electrochemical process instead of combustion, which is how we can deliver the ultraclean emissions. Our basic premise is real simple. We do base load and we do distributed energy. If you remember back in the 1980s when everybody went from mainframes to distributed computing, that's kind of us. We work complementary, if you will, to baseload power plants that might be centralized, but we put these where the power is used for two reasons. One, you can avoid transmission and distribution costs and permitting issues, and two, we actually use the heat as well, so it takes our 47% electrical efficiency, which in itself is high, and raises it up to maybe 85%, 90% total thermal efficiency. We just continue to amplify the efficiency gains. So that's the story behind what we do.

The company itself started as a research company over 40 years ago to focus on batteries and storage. Interestingly enough, as that technology evolved, we got to what our current fuel cell technology is in about 2003, which is the commercialization of the business. Today we have 180 megawatts of ultraclean power generation either installed or in our backlog, including more than 80 plants in approximately 50 locations around the world. We are listed on the Nasdaq and that happened in 1992.

**TWST: Would you tell us more about your clients and the locations of those plants?**

**Mr. Bottone:** We have 11 distinct types of clients or submarkets. We have installations in nine of the 11 different markets. Four of those applications out of the 11 are renewable biogas, and one of the subsegments of renewable is waste water.

We have a wastewater treatment facility, for example, in San Jose, Calif., where they treat all waste water. They basically take the water in and they take the remaining solids and things and put them in a digester. That digester, given certain conditions, creates methane gas. We take that gas, we make electricity from it. So the concept is that they basically produce on-site electricity from effectively free fuel, which frankly is a disposal problem if they didn't get rid of the gas. Methane is a greenhouse gas, so there are regulations preventing its release into the atmosphere. Flaring the methane creates pollutants and wastes a potential source of revenue. So we solve problems for them and create some economic value. There are lots of different municipalities all over the country, that's just one.

On the natural gas side, we have seven different segments, utilities is one of them. Pacific Gas and Electric, I'll give you as an example. They bought two power plants and had us install the plants at two different university locations. What they do is they continue to charge the university for power at the prevailing rate, whatever that is, but give the university the heat that is produced by the power plant. The university, in most cases, has to produce heat of some sort, either boiler heat or hot water or something, and the benefit they get is they basically shut down that apparatus and not use the natural gas they would normally use to feed their boiler, and they get green-

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house gas emission reduction. So everybody wins in that case. In Korea, for example, another model with the utilities is an independent power producer buys a unit, they sell power at a certain price of “X” cents per kilowatt, they buy fuel and pay for maintenance, and they basically have an internal rate of return on that investment. Universities themselves buy these plants to put on campus, because in some cases they can make power and get the heat cheaper than they can buying it from the local utility. It varies, but whether you're in the East, you're in California, you're in Europe, you're in Korea, there are always 11 markets. The economics are different based on the local dynamics in terms of utilities and policy that's in place.

**TWST: Is there a recent example of a new contract or service agreement that's notable that you could offer?**

**Mr. Bottone:** Yes, we can do several. I'll give you ones in California. I mentioned Pacific Gas and Electric. That contract, actually the sales part of it, was done a year ago, and we just commissioned those two power plants and we now have long-term service agreements. I believe in that case those are five or 10-year service agreements, or five years with an option for an additional five years. We did some earlier projects that are being commissioned now that are going into different applications. Some are wastewater and another one is with Southern California Edison, another large utility.

We also provide long-term service agreements between 15 and 20 years. When we say service agreements, effectively what that means is, you own the asset and then for that period of time, you pay a certain fee to us and we operate the plant, service the plant, warranty the plant. So if anything goes wrong, or it doesn't produce what it needs to produce, then we take care of that on our own. It's actually a productivity help for some of these people, because they continue to cut their staff, and they like the fact that they don't have to have somebody to look after this power plant, watch it, worry about emissions excursions, complete maintenance logs and all this other kind of monitoring. So on top of the benefit of the economic value, there is what we call intangible value, which is basically things like productivity and compliance issues. We're doing a big project with Inland Empire, which is one of the largest wastewater treatment facilities in California, if not the United States or the world, that will be installed shortly. They also entered into a long-term service agreement as all of our customers have done. Services represent a consistent source of revenue and is a key growth area for the company.

We're in a transition period where people have been transitioning out of older technology into what we call modern technology, which is large megawatt-scale fuel cells. We recently got an order from our South Korean partner, POSCO Power, for 70 megawatts of fuel cell kits. Many of those projects are going toward utilities, and we have long-term service agreements with them as well. So even though we sell the components of the plant and POSCO puts them together, we actually operate those plants with POSCO learning from us, and we have service agreements. We have an office south of Seoul so we can monitor the plants in South Korea locally or from the U.S. We do it from here as well.

**TWST: You mentioned customers switching out of older technology. Are there any particular trends you're seeing in your customers' needs, as well as technological advances that impact your company? How are you meeting those needs and making the most of opportunities they might present?**

**Mr. Bottone:** Right now, that's the opportunity for us. Whether you believe in global warming or not, there are real issues with climate, or at least air quality, in some of these places, particularly the densely populated centers. Years ago, there were no stationary fuel cell power plants, at least not megawatt scale. We're the only one in the world that builds megawatt-scale fuel cells today. And we did that very strategically for that very reason.

The product itself, there are a lot of reasons I mentioned to you why you'd want to have a fuel cell — it's clean and efficient, doesn't make any noise. The challenge we've had over these years is it's an expensive choice. Fuel cells started in the space program, I think during the Apollo program. We know they work, we know they are reliable, we know all the good stuff, but how do you get the cost down to compete reasonably well with older, more mature, higher-volume technology? Which brings in my engine story. Engines have traditionally been what people had to resort to because there was nothing else. They could do

some turbines if they were a big enough installation, but by and large, people put in engines to generate power. The problem with that is you have to rebuild the engines regularly as moving mechanical parts wear over time. Fuel cells have few moving parts, an air blower is about it. Engines have an emissions profile that varies based on load. What people were basically telling us was, “Look, I don’t want to have to submit reports, and surely we do not want — God help me if I too have — an excursion on emissions.”

Or for a utility particularly, they’re already under enough scrutiny for lots of different reasons. The nightmare for them is that a regulator is going to call them up and say, “Hey, you violated a regulation or law.” So that is a natural rotation for them to get away from the labor issue that comes with more mechanical devices compared to an electrochemical device like ours, and worrying about future requirements that they’d have to comply with which would either add cost or risks, so they derisk their business by putting in fuel cells. For example, one of our customers commented that he no longer has to worry about changes to air permitting regulations.

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**TWST: You recently announced your third-quarter earnings. What were the highlights or key takeaways for you?**

**Mr. Bottone:** There are three. One was that we announced a significant increase in revenue year over year. One of the questions that we always get from analysts is, “How fast can you grow this business?” So basically that says we are growing the business. Second, they ask us, “When do you become profitable?” To become profitable as a company it starts with, “How do you generate gross-margin-positive products?” Well, we’ve been generating gross-margin-positive products, so we checked that box, but now they want to know do we have positive gross margin, and we were able to achieve that for the first time this quarter, since commercializing our power plants. So the next leg of the profitability issue is for the whole company to be profitable, which we’re working on. To get to that, we believe we need about 40% increase in our current production level.

The third piece was that we have a very significant partner in Korea in POSCO Power. POSCO has done some great things in the Korean market, pretty rapid adoption. Many of the things, the renewable portfolio standard program, the 70-megawatt order we got from them is to serve that. But we have been meeting with them and talking to them about increasing their opportunities outside of the Korean market, primarily within Asia, to go after Southeast Asia, because there’s a need. There’s growing demand for clean power. There’s high population density in those areas, and distribution therefore becomes expensive or hard to do. Particularly in Southeast Asia, many of the countries there, Malaysia, Thailand and Indonesia, have local fuel sources, so fuel costs are actually fairly cheap. POSCO wants to expand the market opportunities there. POSCO announced that with our help, they got their first contract outside of Korea, that being in Jakarta, Indonesia. POSCO Power is going to open up a sales office to go after the broader Southeast Asia market, and we’re talking to them about some other opportunities in Asia as well.

**TWST: What’s your outlook for the last quarter of this year and going into 2012?**

**Mr. Bottone:** On the earnings call, Mike Bishop, our CFO, said that we expect in terms of revenue — we’ll show further increases in revenue. In terms of margin, we’ll show improvement in margin, and in terms of other announcements or expansion of opportunities, we’ll have things to talk about in that area as well over the next several months. This is about continuing on a path to profitability, which needs to happen at about 80 or 90 megawatts, and we’re currently running at about 56 megawatts. So we’re executing what we said, and that’s our plan: Take care of our customers and then execute the plan to grow revenue, and profitability is what we really need to do.

**TWST: What is your overall corporate strategy going forward, and what goals do you have for the company over the next year or two?**

**Mr. Bottone:** With pricing at or better than the grid, and taking into account the attributes of what we have to sell and the intangible value — namely ultra clean power delivered efficiently at the point of

use — we have a very compelling value proposition. I believe that even the power industry, after it’s been around for 80-some years, has some incentives, so that’s a pretty tall order to say no incentives at all, and I think there will be some around. But the point is we’re not going to be dependent on delivering profitability with incentives. In the short term, our goal is to get to profitability and then continue to grow from there, expanding margins, because if you look backwards, you can see that our balance sheet and this move to profitability will get us both profitable as well as generating cash.

Specifically how we’re going to get there, we have three strategic priorities. One is growth, and there are several elements of that. One element of that is we need to continue to penetrate further in the markets we’re in, and second is we have to expand internationally to places we’re not, primarily in Europe and expand within Asia. Of course, the announcement from POSCO on moving to Southeast Asia is important, but you can also think about Japan and places like that.

Second, this company was built on operational excellence. We’ve reduced the cost of the product by more than 60% over the last five or six years, and we think we can reduce it about 40% more while maintaining increasing volumes and the quality levels we need to compete in the marketplace. That’s really just more of the same, get operational leverage, which we demonstrated in this quarter, continue to get the product cost down, which we demonstrated this quarter, but we have more to do there.

And lastly, continue to satisfy our customers. We have a solid infrastructure that we built for this company. Today, service is a cost for us, but we believe it will transition to be a sustainable profit center for us. We’re obviously going to continue to support the increased installed base. Probably within the next 12 months we’ll double our installed base. If we look at our backlog and installed base and you look at it on a compounded annual growth rate basis, it’s over 40% over the last five years,

which is no minor task, so we continue to support that broadening of customers. And secondly on the customer satisfaction, what we find shows once we're there, we really become a partner with these folks as we operate their plant. Many times this is a critical part of either their sustainability plan, the plan itself, or their economic model of their plan, wherever it might be. So we want to look to more services that we can provide these people adjacent to what we do. That's what is happening today, by the way: "I know you are here to work on this or maintain the fuel cell, but by the way we have this over here, could you do that, or can you install it for us, or could you get me a permit," or whatever it might be. Those are the kinds of the things that we're focused on in terms of satisfying customers, and in fact, those are good for everybody because they lead to improved revenue and increased margin for us. So those are the three priorities, and those are some of the initiatives that I mentioned.

**TWST: How capital intensive is product development and growing the company? Do you have ready access to capital to fund that growth?**

**Mr. Bottone:** This company, as I said, has been around for a long time, and the development of any fuel cell technology is expensive from an R&D perspective and somewhat from a capital perspective. But it's more the R&D and commercialization effort that really is the expense. It is expensive, and we've been able to do that, frankly, by lots of different means over the years. That creates a huge competitive, sustainable advantage for us, because it's a huge barrier to entry for people because it's hundreds of millions of dollars. We've crossed over that already. We have a commercial product and a rapidly growing installed base.

The second part is going forward. We have to spend less than \$2 million in capital to expand our production capacity from where we are today to get to profitability, so we've already kind of paid up for that. What you find in our business anyway, the way we structured it is, further growth is module, it basically comes in 50- to 70-megawatt chunks of capital, so if you want another 50- to 70-megawatts, it will cost you "X" millions of dollars. But at that point in time, once we reach profitability, we'll have access to perhaps debt financing, which we don't today, because primarily we have had to raise equity for what we have done. But we'll be generating our own cash at that point, so the combination of minding our cash flow today and being able to generate our cash in the future, then we'll be able to fund that growth we believe. For somebody else who is new in the market, it's a huge barrier.

**TWST: Is there anything else that you'd like to discuss?**

**Mr. Bottone:** To summarize, it is about growth and it's about profitability of the company. We have the right product for meeting the global energy challenges of today by providing ultraclean power in a highly efficient manner at the point of use.

People will say, "You don't have a strong balance sheet." You can argue that both ways. On paper, it doesn't look so strong, but we've gone a long way with basically providing necessary capital liquidity we needed at the time. But we have a real clear plan. Everybody here knows what it is, we've communicated what it is, we've all signed up for it on two horizons — one is to execute our path to profitability, which is 80 to 90 megawatts and what it takes to get there, and then we want to continue to grow well beyond it.

We tell people what we're going to do, and we want to deliver what we say — that's what we try to do here. Is it easy? No, certainly not. If it was so easy, somebody would've done it already. But we've been at this for a while. We're a commercial venture now, and I think we've picked a place that is the most attractive space in the market with a product that scales the most to allow us to deliver those long-term goals. There are other people in the fuel cell industry that are in much earlier stages than we're at, and at that point you don't know what you don't know. So we're quite keen on the future. We just have to execute on what we know we have to execute.

**TWST: Thank you. (MN)**

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