

# **Fuel Tech, Inc. (FTEK) Q1 2024 Earnings Call Transcript**

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**Body**

Fuel Tech, Inc. (FTEK)

Q1 2024 Earnings Conference Call

May 08, 2024, 10:00 AM ET

Company Participants

Devin Sullivan - MD, The Equity Group

Vince Arnone - Chairman, President and CEO

Ellen Albrecht - CFO

Conference Call Participants

Amit Dayal - H.C. Wainwright

Marc Silk - Silk Investment Advisors

Presentation

Operator

Greetings. Welcome to Fuel Tech, Inc. First Quarter 2024 Financial Results Conference Call. [Operator Instructions] Please note, this conference is being recorded.

I will now turn the conference over to Devin Sullivan, Managing Director of The Equity Group. Thank you. You may begin.

Devin Sullivan

Thank you, Sherry. Good morning, everyone, and thank you for joining us today for Fuel Tech's 2024 first quarter financial results conference call. Yesterday, after the close, we issued a press release, a copy of which is available at the company's website, www.ftek.com .

Our speakers for today will be Vince Arnone, Chairman, President and Chief Executive Officer; and Ellen Albrecht, the Company's Chief Financial Officer. After prepared remarks, we will open the call for questions from our analysts and investors.

Before turning things over to Vince, I'd like to remind everyone that matters discussed on this call, except for historical information, are 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 company's management.

Fuel Tech has tried to identify forward-looking statements by using words such as anticipate, believe, plan, expect, estimate, intend, will, and similar expressions, but these words are not the exclusive means of identifying forward-looking statements. These statements are based on information currently available to Fuel Tech and are subject to various risks, uncertainties, and other factors, including, but not limited to, those discussed in Fuel Tech's annual report on Form 10-K in Item 1A under the caption of Risk Factors and subsequent filings under the Securities Exchange Act of 1934 as amended, 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.

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Investors are cautioned that all forward-looking statements involve risks and uncertainties, including those detailed in the company's filings with the SEC.

With that said, I'd now like to turn the call over to Vince Arnone. Vince, please go ahead.

Vince Arnone

Thank you, Devin. Good morning, and I'd like to thank everyone for joining us on the call today.

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Given that we last spoke not that long ago in connection with our year-end results, I'll keep my commentary brief today. Although we've begun the year more slowly than anticipated in our APC and FUEL CHEM business segment, we expect that our performance for these businesses will show steady improvement as we move through 2024.

In addition, we are very encouraged by the progress we are making at our Dissolved Gas Infusion or DGI business initiative, and we ended the quarter in a very strong financial position with cash, cash equivalents, and investments of over $32 million and no long-term debt.

Now let's discuss our results for the first quarter in more detail. As a general statement, our results reflected the impact of customer-driven delays in the execution of existing contracts in our APC business segment, while our performance in FUEL CHEM was impacted detrimentally by historic warm weather across the U.S. that affected unit dispatch and by unscheduled plant outages.

For the APC segment, I remain pleased with our ongoing execution of existing projects and our team's current business development activities, which continue to reflect an increased focus on global emissions protocols across a variety of fuel sources.

In 2023, we benefited from the continued adoption of our ULTRA SCR, SNCR, and FTC emissions control solutions at natural gas and coal-fired units in the U.S., Europe, South Africa, and the Pacific Rim, and I expect this to continue into 2024 and beyond.

Independence of the potential impact of favorable regulatory outcomes, which I will discuss shortly, we are well positioned to take advantage of current industrial market trends, which include plant capacity expansion across several industries, the incentivized use of small turbines to replace traditional less clean power generation, the development of the biocarbon industry, the continued emphasis on decarbonization on a global basis, and the focus on using our ULTRA systems as the safe source of ammonia for SCRs at hospitals and universities across the U.S.

We are providing proposals to customers for both near and longer-term needs regardless of regulatory drivers, and we are currently watching the progress of $5 million to $10 million in APC contract opportunities that could close in our favor before the end of the second quarter or shortly thereafter.

Now on the regulatory front. We continue to monitor progress related to the adoption of the U.S. EPA's Cross-State Air Pollution control regulation to meet the good neighbor requirements of the Clean Air Act, which we believe can be a potential catalyst for APC growth in 2024 and for the remainder of this decade, as utility and industrial customers explore ways to further reduce NOx emissions.

Over the past several months, we have received and responded to multiple requests for budgetary proposals as customers prepare to address the upcoming compliance requirements as part of their capital budget planning for this year and beyond. As discussed on previous calls, the rule currently obligates 23 states to reduce emissions of nitrogen oxides from power plants and certain industrial facilities to limit their impact on downwind states.

The ultimate timing of the effectiveness of the rule is uncertain because several upwind affected states and sources have challenged the efficacy of EPA's proposed regulation in multiple courts and stays of the effectiveness of the rule have been issued for many upwind states.

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In February of this year, oral arguments were presented to the Supreme Court by both sides, and we are closely monitoring the potential impact of the Supreme Court's ruling on whether to stay the rule for all states when it is issued later this year.

In addition to the good neighbor rule, we are also watching the progress of EPA's rule for large municipal waste combustor units, which is independent of the good neighbor rule. This rule reduces the nitrogen oxide emissions requirements for large municipal waste combustor units.

Fuel Tech has had a long history of assisting this industry in meeting its compliance requirements, and we have had discussions with customers in this segment to support them in their compliance planning. The municipal waste combustor rule is currently in a public comment period with compliance deadlines expected sometime in the next three years.

Lastly, within the past two weeks, EPA has issued new stringent greenhouse gas emission standards that require 90% reductions for most new gas-fired plants and existing coal units by 2032. This same proposed rule tightens the mercury and air toxic standards requirements by 2028, wastewater discharge limits for coal-fired power plants by 2029, and ash handling and disposal from coal-fired power plants over the next several years.

This combined rule comes at a time when there are projections of potential shortfalls in power generation over the next five to seven years in certain geographic regions in this country due to data center power demands and increases in computing power requirements resulting from the adoption of artificial intelligence. And we are in the process of evaluating the potential impact of these rules across our technologies in the power generation market.

Now for the FUEL CHEM segment. Revenues declined from the prior year first quarter due to a decrease in operational demand from our client base resulting from warm weather across the U.S. and, to a lesser extent, unscheduled plant outages and closures compared to the same period in 2023. As mentioned on our last conference call, we have been pursuing multiple additional FUEL CHEM development opportunities, which could provide incremental revenue contribution in the second half of 2024 for both coal and biomass fired boilers.

I'm very pleased to say that we have received an order for our FUEL CHEM demonstration at a new coal-fired power generation site in the Western U.S. The demonstration is expected to commence later this month. And if it becomes a commercial account, is expected to generate annualized revenue of approximately $1.5 million to $2 million at historic FUEL CHEM gross margins.

And in addition to this domestic opportunity, we are in discussions with one additional coal-fired power generation facility regarding a demonstration later this year, also in the Western U.S. and we are also pursuing an opportunity to address the concerns of a biomass-fired boiler operator.

With respect to international FUEL CHEM opportunities, we remain in discussions with our partner in Mexico to expand the provision of our chemical technology in that country. We expect that the nation's upcoming presidential election in June will provide us with additional clarity on the likelihood of this opportunity as the favorite candidate is an environmental engineer by background and could take a favorable position on the implementation of environmental policy. We will provide more color on this opportunity on our next conference call.

As we move into the second half of 2024, we expect FUEL CHEM revenue to improve due to the increased power demand and associated unit dispatch that comes during the summer months and the contributions from the new coal-fired unit demonstration that will commence later this month.

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With our DGI initiative, our momentum continues. Last month, we executed an agreement to commence and complete a demonstration of DGI at a municipal wastewater site. In this instance, our DGI solution will be used to reduce hydrogen sulfide and the wastewater, the oxygenation to reduce corrosion inside the wastewater lines. This application will demonstrate DGI's capability to extend the life cycle of aging infrastructure and eliminate the need for costly maintenance activities.

Following the successful demonstration of our technology at a U.S. shrimp farming facility last year, we are in discussions with the owners of that same facility to incorporate DGI into their commercial scale plant stacked raceway system. The client is expecting to have their aquaculture system functional by the end of the year, and we are in the process of providing a proposal for a DGI system that will meet the precise needs of this aquaculture environment.

Additionally, for aquaculture, we are in discussions with a potential new aquaculture client in the U.S. that is considering incorporating DGI into a greenfield fish hatchery site in the Western states.

There are many other target markets of interest for DGI, including pulp and paper, food and beverage, petrochemical, and horticulture, and we look forward to addressing these markets prospectively.

On the marketing front, we have been increasing our efforts to communicate the benefits of DGI to targeted end markets and customers, and we will be present at additional conferences later this year.

Based on our effective backlog today, the business development activities we are pursuing and our previously noted expectations for FUEL CHEM, we expect that total revenues for 2024 will exceed the total revenues recognized in 2023 of $27.1 million, and we will provide further guidance as we move throughout 2024.

This base case outlook excludes any material contributions from DGI as we are still in the early stages of commercialization, any significant contributions to APC from the above-referenced EPA regulations and the impact of material business development activity for FUEL CHEM.

In closing, I want to thank the Fuel Tech team for their continued contributions to our business. It is their hard work, passion, and dedication that drive our ability to be successful as a company. Additionally, I thank our shareholders for their continued support. We continue to expect that 2024 will be an important year in the growth and development and evolution of Fuel Tech, and we look forward to keeping you apprised of our progress.

Now I'd like to turn the call over to Ellen.

Ellen Albrecht

Thank you, Vince, and good morning, everyone.

For the quarter, consolidated revenues declined to $5 million from $7.3 million in last year's first quarter, reflecting declines in both the APC and FUEL CHEM segment from the prior year period. APC segment revenue decreased to $2.3 million from $3.6 million in the first quarter of 2023, primarily related to customer-related delays and project execution.

FUEL CHEM segment revenue declined to $2.6 million from $3.7 million in the first quarter of 2023 due to a decline in electrical generation demand and unscheduled plant outages. Consolidated gross margins for the first quarter were 41% of revenues, an increase from 38% in the first quarter of 2023, reflecting an increase in APC segment gross margin to 38% of segment revenues from 27% in the prior year period due in large part to the mix of projects and services executed during the quarter. FUEL CHEM segment gross margin declined to 43% from 49% in the first quarter of 2023 as a direct result of lower segment revenue.

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We expect FUEL CHEM segment margins to return to historical levels as we continue throughout the year. Consolidated APC segment backlog on March 31 was $6.2 million, down from a backlog of $7.5 million at December 31, 2023. Backlog at March 31, 2024, included $1.8 million of domestically delivered project backlog and $4.4 million of foreign delivered project backlog compared to $2.6 million of domestically delivered project backlog and $4.9 million of foreign delivered project backlog at December 31. We expect that $6 million of current consolidated backlog for the APC segment will be recognized in the next 12 months.

SG&A expenses increased slightly to $3.3 million from $3.2 million in Q1 of 2023, reflecting higher employee-related expenditures. Given the decline in revenue, SG&A as a percentage of revenue in the 2024 first quarter increased to 68% from 45% in the same prior year period.

Research and development expenses for the first quarter rose to $376,000 from $218,000 in the same period a year ago, mainly reflecting our ongoing investment in the development of new technologies to expand our product offerings into the water and wastewater treatment market and more specifically, our DGI systems.

Our operating loss was $1.7 million compared to a loss of $658,000 in last year's first quarter, reflecting a reduction in overall revenue, a shift in margin contribution from product mix and slightly higher operating expenses for the quarter. We continue to take advantage of the favorable interest rate environment.

And as of March 31, have invested more than $30 million in held-to-maturity debt securities and money market funds. This generated $311,000 of interest income in the first quarter compared to $339,000 in the prior year period.

Our net income for the quarter was $281,000 or $0.01 per share compared to a net loss of $414,000 or a loss of $0.01 per share in the same period one year ago. Net income for the first quarter of 2024 included an extraordinary other income amount of $1.7 million related to the recording of income associated with the expected receipt of the employee retention credit during the quarter as compared to an other expense of $90,000 in last year's first quarter.

For those of you not familiar with the employee retention credit, the CARES Act established by the U.S. government was enacted to provide certain relief as a result of the COVID-19 pandemic. This tax relief, along with other stimulus measures, allowed for employers to claim a refundable tax credit against the employer share of social security tax for qualifying periods in 2020 and 2021, subject to certain criteria.

Under the provision of the CARES Act, the company was eligible for refundable employee retention credit, which was claimed in Q1 of 2024. Adjusted EBITDA loss was $1.5 million compared to an adjusted EBITDA loss of $569,000 in the same period last year.

Lastly, moving to the balance sheet. Our financial condition remains very strong. As of March 31, we had cash and cash equivalents of $11.4 million and short and long-term investments totaling $20.7 million. Working capital was $27.7 million or $0.90 per share, stockholders' equity was $44 million or $1.43 per share, and the company continues to have no outstanding debt.

To reiterate Vince's earlier comments, we remain confident in our ability to fuel our growth initiatives, pursue new product and market opportunities and maintain our strong financial position, which we view as an important competitive advantage, given ongoing macroeconomic uncertainties. We have a pipeline of significant growth opportunities across business segments that position us for positive growth in 2024.

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I'll now turn the call back over to Vince.

Vince Arnone

Thanks very much, Ellen. I would like now to turn the call back to operator for questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question is from Amit Dayal with H.C. Wainwright. Please proceed.

Amit Dayal

Thank you. Good morning, everyone.

VinceArnone

Good morning, Amit.

Amit Dayal

So with respect to -- I know weather-related issues, et cetera, caused a little bit of weakness in 1Q. But overall, have we been adding new customers? It looks like in the FUEL CHEM segment, you may have added new customers. Just, Vince, maybe if you could give us some color on how that part of the business is holding up in terms of new customer additions, et cetera.

VinceArnone

Right. I would say in terms of adding new customers, this year is really in terms of those types of opportunities, we're seeing more of them this year than we have in a little while, which is great for us to see at this point in time.

As I mentioned as part of my script, we just signed an order for a demonstration that will literally be starting in about two weeks' time. And so we're encouraged about that opportunity. It's a large coal-fired unit in the Western U.S. And we're in discussions with the second coal-fired unit, similar geographic location, coal-fired, as I said, and also a large unit. And that possibly could start sometime in Q3.

And then on top of that, we've had some discussions with some owners of biomass fired boiler units as well that also could be new business opportunities. So I would say this year is really the first year in a while that we're seeing a larger scale of new business opportunity. We have not seen that in the past couple of years. So it's a new outlook for us.

It's driven by pressures for those remaining coal-fired utilities to reduce their cost structure. It's driven by the need for some units to be available to run as support power for certain regions of the country and other drivers as well.

So I'm very pleased that we're seeing the chem tech opportunities come in our direction. They are very solid gross margin generating business opportunities. And I would love to be able to see total revenue from chem tech kick back up to where it was four or five years ago. I'm not saying it's going to get there. But any addition that we can bring on board right now, particularly in a coal-fired unit, is a nice benefit for us. So a long answer to your question.

Amit Dayal

You also mentioned sort of the increase in electricity demand stemming from AI and data needs, et cetera, that is underway at a macro level. You have a balance sheet. I know your immediate products may not directly cater to those opportunities, but are you thinking about any acquisition opportunities that brings you closer to those types of opportunities going forward?

VinceArnone

Nothing that we're looking at right now, Amit. When we talk about some of those macroeconomic trends, it ultimately is supporting some of the, call it, lengthening of the life of the utilization of a lot of the coal-fired units. That in its own right is going to hopefully mean additional business for Fuel Tech and our current technology suite. So we're looking at that macroeconomic trend in a favorable light as we sit here today.

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But we aren't necessarily pursuing any acquisitions that would provide us the ability to address other needs, if you will, that are driven by additional power demand, whether it be AI or data centers and the like. But those trends are generally favorable for Fuel Tech, as are the trends in support of some additional environmental regulation.

Amit Dayal

Understood. Thank you. Just last one for me on the DGI side. It looks like you potentially could convert the pilot generic shrimp farm into a customer. Like how big should we think these order sizes can be when you deploy sort of a full system or a full scale offering with these types of customers?

VinceArnone

So to answer your question, yes, we are hopeful that we're able to go ahead and convert that demonstration, which was indeed successful to a commercial sale. We're looking at putting the configuration together for a DGI system that will meet the needs of a commercial scale system for this shrimp farm owner, if you will. Right now, I'd probably see this as a capital sale. And I'm just going to give you a ballpark in terms of what this system would be offered at. And I'd say, $0.5 million to $1 million in terms of a capital sale of a DGI system, just to give you a ballpark range.

Amit Dayal

And when these are deployed, Vincent, do they also -- do you attach sort of maintenance type of contracts or additional revenues?

VinceArnone

Yes. To the extent we're able to build in support aftermarket contracts, we will. I still think we have a little bit to learn relative to the deployment of these systems at sites and the ongoing necessary maintenance that's going to be required. We're not expecting that it's going to be extensive at customer sites once it's up and running. But to the extent that we can provide ongoing support on a quarterly basis or whatever is needed via the contracts that support that activity, we'll definitely look to do so.

Amit Dayal

Okay. That's all I have, Vince. Thank you so much.

VinceArnone

Okay, Amit. Thank you so much.

Operator

[Operator Instructions] Our next question is from Marc Silk with Silk Investment Advisors. Please proceed.

Marc Silk

Hi Vince, thanks for taking my questions.

VinceArnone

Hi Marc, no problem. How are you?

Marc Silk

I'm doing fine. Thank you. On the APC delays, was that -- is that really basically because of the court issues or this is just a regular delay?

VinceArnone

I would say more regular delays, yes, not necessarily related to court issues because with the business that we were expecting to pull into 2024, we really didn't factor in anything that was going to be regulatory driven. That would be what I would call incremental business opportunity for us, and we'll know more about that a little bit later on this year. So I would call the delays just normal delays in both project execution and in coming to contract with certain potential customers.

Marc Silk

Okay. That's encouraging. And then in your guidance, you're basically not putting in there any positive court rulings, correct? So that could be a surprise on the upside?

VinceArnone

That's correct.

Marc Silk

On the FUEL CHEM, that's actually exciting that it's coming to life a little bit. It's also -- you laid out really the reasons, but another one I want to know is, is it because also there's not many other competitors anymore, just because it's not a growing industry?

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VinceArnone

Actually, for this particular technology application market, there really aren't any competitors for what we do specifically with FUEL CHEM. But it requires a specific customer need for us to be utilized, and our program is not inexpensive. But if we offer a client the ability to keep their units running during high demand times and by perhaps using a lesser quality coal or a difficult to burn coal, they recover the cost of our program very, very quickly. So, no one else does what we do with this technology, but the very specific need isn't necessarily out there at all coal-fired units.

Marc Silk

Okay. That's great. And then the -- I'm intrigued by this municipal wastewater site. Can you talk more of this? Like, what are they looking for? What are you bringing to the table? That's the first question, and then we'll go from there.

VinceArnone

Yes. So the site we're looking to demonstrate at is it's, again, it's a municipal plant. And in certain stages of the treatment process. There are areas whereby the wastewater becomes less than oxygenated or it has less oxygen that it needs to go ahead and maintain what I would call good quality water. And in this part of the application when it doesn't have the oxygen it needs, it actually creates hydrogen sulfide. And over time, hydrogen sulfide is going to erode the insides of those lines.

So, the application we're working on is specifically attempting to keep these feed lines as part of the wastewater treatment plant keeps them oxygenated at specific levels whereby they don't create any detrimental effects to that piping system.

Marc Silk

So how do they find you, by the way?

VinceArnone

How do these guys find us? That's a good question. Actually, these folks actually were a contact of Bill Decker. Bill is the gentleman we hired last year to help us support the development of DGI. So, these folks that we're working with are well established in the wastewater treatment industry. And hopefully, they will turn out to be a good partner of Fuel Tech prospectively.

Marc Silk

So the interesting thing is with municipalities versus private industry, it's not a competitive, let's say, competition, right? So are you able to kind of work with them and say, listen, we want other municipalities to watch this so it's more of an open trial just because it's going to benefit really any water, I mean, any municipality in the country?

VinceArnone

Yes. We're really -- we're taking this step by step, right? What we need is a first success. And once we have the first success, then we'll be able to work with that documented science-based, data-driven results. And then we can expand on that documentation, if you will, with other municipalities. So, I think we need to take the first step here and ensure we have a successful demonstration, and then we move forward from there.

Marc Silk

And then I know last call, someone was asking about insider buying. So hopefully, it sounds like you're getting your ducks lined up. So hopefully we see some more insider buying, and good luck going forward.

VinceArnone

Okay. Marc, thank you very much.

Operator

We have reached the end of our question-and-answer session. I would like to turn the call back over to Mr. Arnone for closing comments.

Vince Arnone

Thank you, operator. I'd like to thank everyone that joined the call today. I'd like to thank the entirety of the Fuel Tech team for their support on Fuel Tech's activities. And as usual, thank all of our stakeholders, shareholders for their continued support of Fuel Tech.

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Everyone, have a great day, and we'll talk to you again soon. Thank you.

Operator

Thank you. This will conclude today's conference. You may disconnect your lines at this time, and thank you for your participation.

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