

THE WALL STREET TRANSCRIPT

Questioning Market Leaders For Long Term Investors

FuelCell Energy, Inc. (FCEL)



JOSEPH G. MAHLER, Chief Financial Officer of FuelCell Energy, Inc., joined the company in October 1998 as Vice President, Chief Financial Officer, Corporate Secretary and Treasurer. Mr. Mahler's responsibilities include finance, accounting, corporate strategy, treasury, information systems and human resources. Prior to joining FuelCell Energy, Mr. Mahler was Vice President-Chief Financial Officer at Earthgro, Inc., from 1993 to 1998 and worked at Ernst & Young in the New York and Hartford offices from 1974 to 1992. He was a partner in the Hartford Office's Entrepreneurial Services Group. Mr. Mahler received a BS in Accounting from Boston College.

TWST: What is FuelCell Energy?

Mr. Mahler: FuelCell Energy is a manufacturer of ultra-clean electric power generation plants for commercial, industrial and utility customers. We use a technology that electrochemically can take hydrocarbon fuels, such as natural gas, wastewater treatment gas, or other alternative gas, and then effectively reform the hydro-carbon fuel to hydrogen inside our fuel cells. We are, in effect, a hydrogen generator. We can produce high efficiency electricity and high quality heat from our products, which adds to our economics. The key for us is that we do not combust the fuel. By processing electrochemically, we are ultra-clean with minimal emissions, and reduced CO₂ into the atmosphere. It's a very environmentally positive product.

The company was founded in 1969 by Dr. Bernie Baker. He was a leading proponent of fuel cells and had the vision to develop this technology that he believed had the lowest cost drivers of all the fuel cell technologies. We have been developing fuel cells as well as batteries and other electrochemistry since that time. In 2003, we shipped our first commercial product to Kirin Brewery in Japan. Since that time, we now have more than 60 units installed worldwide from Germany to Korea, to Japan, to the United States, and one in process in Canada at this point.

TWST: Give us an idea of where you fit into the power marketplace today.

Mr. Mahler: I'm going to focus on the fuel cell industry first and then I'll actually move on to solar and to wind. In the fuel cell industry, each technology seems to have its own set of applications. For example, our fuel cell technology is designed for the distributed genera-

tion stationary market. Our fuel cells are utility grade, base load products sized from 300 kilowatts to 50 megawatts. To give you some scale, our 300 kilowatt units can provide electricity to about 200 homes or a small 300-bed suburban type hotel like the Sheraton in Parsippany, New Jersey. Our products include 1.2 and 2.4 megawatts individual products. Our 2.4 megawatts products can be scaled into 10, 20, 30, or up to 50 megawatts sizes to allow for grid support for electric utilities.

Our products produce electricity at a very high efficiency rate, close to 50% electrical, and up to 80% with combined heat applications. To compare that to some of the other fuel cell technologies, a fairly well-known technology is PEM technology, and that is what companies like Ballard and Plug Power are using. This technology operates at a lower temperature and its application opportunities are with both transportation and backup scenarios. So in that sense, the attributes of a PEM fuel cell are not effective in our markets, like the utility grade application. PEMs are better in transportation and back-up markets because you can turn it on, turn it off, and they operate at a lower temperature. They run pretty clean, but with an efficiency that is 10 to 15 percentage points lower than ours.

There are other versions of fuel cell technologies including another high-temperature technology called solid oxide that competes against us for the utility grade market. At this time, they are probably a couple of years behind us in commercializing their products. Then there is next generation technology, which is called solid oxide planar, which is probably five to seven years from commercialization. We have partial ownership of a company that is developing solid oxide planar technology named Versa Power Systems, Inc.

Our primary competition at this time is the electric grid, reciprocating engines and gas turbines. Our advantages against this competition include no combustion, minimal emissions and quiet operation.

And then you have the renewable technologies, wind and solar which are growing markets rapidly. We are really part of that growth in the sense that what we offer a product that is ultra-clean but importantly can also operate 24 hours a day and seven days a week. In comparison, wind and solar are intermittent. As you put more and more intermittent power on the grid, you need to balance that with 24/7. We really do own a piece of that market.

Just to give you a quick example, one of our customers is Sharp Electronics in Japan. They are the largest manufacturer of solar cells in the world but to operate their plant three shifts they need 24/7 power generation. At their new television LCD manufacturing plant, they opted, because of our 24/7 ultra-clean attributes, to power the plant with a one-megawatt fuel cell. This way they could capture the 24/7 power they need and still comply with Kyoto requirements. So that's really where we fit into this marketplace as we bring ultra-clean electric generation and 24/7 reliability to our customers.

TWST: What are the cost comparatives for the input? What are the economics that make this very viable and attractive?

Mr. Mahler: First of all, the prime driver for our product is economics with the key being our high fuel efficiency. That far outweighs everything else because when you are running a power plant for 20 plus years, the highest cost that you are faced with is the fuel cost. We bring competitive efficiency to the table with even the large-scale power plants. For example, a larger scale power plant, say 400-600 megawatts in size, probably operates somewhere between 50% and maybe 60% electrical efficiency depending on weather, temperature, altitude, etc. At a much smaller size, we are currently delivering efficiencies in the 47%-50% range on a single cycle basis and in combined heat and power applications, we expect to exceed 60% plus. So that's really the key. The key is efficiency.

When you get to fuels, a strength of our technology is that we can process multiple hydrocarbon fuels at similar efficiencies. We can also utilize renewable bio-fuels including wastewater treatment gas, which is one of our leading markets. In a wastewater treatment plant, methane is produced that our fuel cells can turn into electricity that can power the wastewater treatment facility and in many cases, sell excess electricity back out to the grid. So it's a very good economic solution.

We currently have 60 installations worldwide and are building volume. In order to do that, there are several areas of the world that will help to promote this technology because of its superior attributes including California, Korea, Japan, Germany, Canada and Connecticut.

There are really two things we look for from these markets. We look for some early subsidy money to overcome the classic low manufacturing volume that results in high initial costs and, second, relief from the constraints that exist against distributed generation.

The volume issue will take care of itself. As we get more volume, our costs will reduce in line to the point where we can eventually, and not in the too distant future, go unsubsidized to market.

These markets are also helping to relieve constraints against distributed generation. For definitional purposes, we consider power plants under 50-megawatts to be distributed generation. If you try to go to market today, there are protections for central utilities such as exit

fees, standby fees and interconnect fees. The key markets — Germany, the Northeast, California and Asia — understand the constraint issues and have given us relief in order to allow adoption of a superior technology. The markets are all a little different in how they have actually interpreted that, but they are all putting some dollars on the table and giving us relief from these artificial constraints.

In New York City, we have a fuel cell, a small one, 300 kilowatts, at the Sheraton Towers. When we first tried to install it, the local utility notified us that we would owe them \$0.06 a kilowatt-hour for taking power off their grid, which would make the economics very difficult. New York State, recognizing the issue, created an exemption for ultra-clean power generation products that allowed us to operate without penalty.

To give you some idea of the types of credits that are available, California is our leading market at this point in time. It's a high-energy cost market and is very sensitive to air emissions and greenhouse gas. They have created a pocket of money, about \$80 million a year, to promote ultra-clean technologies. The current subsidy for fuel cells is between \$2,500 for units operating on natural gas per kilowatt and \$4,500 per kilowatt on wastewater treatment gas or biogas. Other markets have similar programs.

The big news for us recently was in Connecticut, where they have a Renewable Portfolio Standard that requires a certain percentage of their total state generation to come from renewable or ultra-clean sources. In this case, we meet the criteria for this program. We were awarded six projects totaling 68 megawatts of fuel cells. I'm not sure we are going to get all the projects once you go through the regulatory process, but that's quite a representation of how fuel cells can really help put clean electricity into the marketplace.

The other major development we have had recently is the signing of a distribution and manufacturing agreement with the South Korean company POSCO Power. They also announced that they were going to invest up to \$70 million to build a plant that can manufacture up to 100 megawatts of power plants in Korea using our fuel cell modules. The activities in California, Connecticut and South Korea demonstrate that the marketplace understands the excellent attributes of our products and are looking to move forward with volume at this point.

TWST: What's the agenda? What are your priorities for the next 12 months? What would make that time frame a success for FuelCell Energy?

Mr. Mahler: Our priority is to make sure we capture the 68 megawatts awarded in Connecticut and to continue to increase order flow in the Asian and California markets. The best market for us so far has been the California market. They are early adopters of technology. When they see a superior product, they buy it. We are getting tremendous traction in California from hotels, wastewater treatment plants, universities and institutions and manufacturing plants. A great customer is the Sierra Nevada Brewery in Chico, California, that is using their plant to improve their power reliability and reduce cost.

We continue to focus on reducing the cost of our product as the lower it goes, the broader the markets that open up for us. We believe we can get our cost below market clearing pricing on these products. Our ultimate goal is to deliver under \$0.10 per kilowatt hour electricity. We need a couple of steps to get there, but our path is pretty clear. Once we get some volume through our facilities, we can get to profitability as a company very quickly.

TWST: What's the mechanism where green credits would apply? If someone had, say, a coal burning facility and they had other gases or wastewater associated with it, could this balance out some of the negativity that's being generated? Is that system available?

Mr. Mahler: Yes, it's actually getting stronger as we speak. The whole carbon credit system is beginning to take some real shape. In Connecticut, for example, we are getting some requests, now that they have a renewable portfolio standard program and it looks like they are going to have large scale renewable/ultra-clean projects coming soon, there appears to be a market developing to buy those credits. Those credits can be worth anywhere from \$.005 to \$.03 per kWh at this time, and perhaps in the future, if you look at projections for carbon trading and other emission credits, it could go even higher than that. Those are all real dollars and so fuel cells can absolutely participate in that market.

Also helpful to us, the US federal government has an investment tax credit for fuel cells, which credits another \$1,000 a kilowatt, up to 30% of the product cost. So broad public policy is certainly starting to push. As they see more fuel cells in the market, as they see the performance, and you start to get the customer drive, you are starting to see response, certainly from governments. Because of this, we are starting to see a real path where you can get product volume.

For example, last year, we did approximately six megawatts of sales. In 2007, we already have three megawatts in house and you are talking about 68 megawatt potential orders from Connecticut that could come through sometime in June or July. So you are really looking at an inflection point. I think the marketplace is comfortable with fuel cells and I think all these factors will help push the whole fuel cell industry forward and get this superior technology in.

TWST: Introduce us to your top-level management team. Who are two or three of your key individuals?

Mr. Mahler: The President and CEO is Dan Brdar. Dan was promoted to President and CEO about a year ago and just recently became Chairman of the Board. Before becoming CEO, he had a marketing role and then he took over the product team. He was working specifically on getting cost out of the product and also improving its reliability and availability. From an availability and reliability standpoint, our customers are very comfortable with the product. It's inherently more reliable than competing technologies because there are less moving parts. The cost-out program has been very successful. We have been able to take significant cost out with value engineering at this point in time. We haven't really run the volume equation. When we add volume, you get opportunities to improve manufacturing processes, and you get to global source to reduce cost. And then the ace in the hole in our case is the ability to improve your technology, if you can get more power out of your fuel cell modules with the same balance of plant, you actually lower your cost. Dan comes from General Electric where he led new product development teams. He was also part of the Department of Energy, where he was leading some of the clean coal initiatives.

Bruce Ludemann is Vice President of Sales and Marketing, and he comes out of Siemens. He has large scale power generation background and he will be targeting the utility markets for using fuel cells for distributed generation. The primary point there is that it's just going to be cheaper to put a clean, scalable product into a local market situation to avoid grid constraints and help commercial and industrial customers as opposed to adding large scale central generation with associated transmission and distribution.

I have been at FuelCell Energy since 1998 and joined as part of the initial commercialization team. At that point, it was really a company that was doing research and development, mostly for the federal government. We have now transitioned that effort into a commercial company as we head into our inflection point. There are many more who have helped move this company into its current position but these are a couple of the key members of the management team.

TWST: What has been the financial picture to date, with respect to balance sheet and P&L? At this point, what items have priority for improvement? Give us bit of a financial outlook as you move into this inflection point stage.

Mr. Mahler: Our drive is to get to profitability as a company. Since 1999, we have invested capital to drive market acceptance of our products. We believe we now have a clear picture of how to increase volume and move to profitability. Our largest power plants are at market clearing price, which means they pretty much can go unsubsidized at this point. These are niche markets to begin with, but we believe we can get the product cost down to open the broader markets. Every penny you drop on your price opens up more market. So our plan is to focus on our multi-megawatt business to increase volume.

For example, this Connecticut Project 100 is exactly that — it is a multi-megawatt opportunity. If we got the whole 68 megawatts, we would utilize somewhere between 30 and 35 of our 2.4 megawatt plants. That kind of volume drops our cost even further and we would expect to be gross margin profitable on these sales. I don't think you hear that much from fuel cell companies. The volume will allow for accelerated cost reduction on all of our products. As it moves us faster to gross margin profitability, it will open up project finance opportunities and it will allow us to start to open working capital lines of credit which will allow us to better leverage the equity in the company.

We currently have about \$125 million of cash and recently we just completed a capital raise of approximately \$63 million increasing our cash to more than \$180 million. We are burning an average of \$15 million a quarter, so that's about three years worth of cash at this point. We feel pretty comfortable with that. We have good access to the markets for capital and that's the key. The key is manage cash and continue to execute, putting volumes through our facilities to move our product to gross margin profitability. So it's all moving according to plan. I think we have laid out this strategy for years and this seems to be the year that the marketplace and the large potential order flow can come into play.

TWST: What historically has been the shareholder base with the company? Has that base undergone any changes?

Mr. Mahler: The shareholder base is composed of fairly long-term holders. We have a couple of strategic investors in POSCO and in our German licensee, which is the old MTU, but it's now called CFC Solutions in Germany. POSCO owns about 7% and CFC owns about 4%. We have some large investors, such as BlackRock out of London. They are a large investor, in the 6%-7% range. We have TCW, which has been a long-term supporter of our products and has been very helpful to us. And then we have some good holdings from the European ethical funds. Their sustainable funds have been terrific investors. Then we have a good group of US investors that have been in for quite a while, actually. We have above 50% institutional holdings, which is good for a company of our size and that level has been fairly stable.

TWST: In your discussions with the investment community, are there any recurring questions or misperceptions that you encounter? Do you believe that the investment community understands the FuelCell Energy story?

Mr. Mahler: I think our current investors understand the story well, but I think the broader potential investor group is not clear about fuel cells. They are not clear on the differentiation between us and some of the other fuel cell and alternative energy technologies. These products and technologies have struggled over the last five years and I find there is a lot of skepticism about fuel cells. If you look at the current alternative energy investment sector, solar is now booming. Solar is a heavily subsidized technology. It has to be 50% subsidized in the California marketplace by the California rate tariffs, but that industry is booming, because broad public policy for solar in California, Germany and Asia has created enough room for an industry to grow. As we break out of the pack, we believe we will get the same opportunities.

We are trying to differentiate ourselves from the other alternative energy companies. I think that validation like POSCO building a 100-megawatt fuel cell facility in Pohang, South Korea, and the fact that we were awarded almost 68 megawatts of potential contracts out of Connecticut is quite a strong statement for us.

TWST: What are the key metrics and key events that investors should focus on now as they track your performance? What matters?

Mr. Mahler: What matters is continuing to see that these markets open; I think it's increasing order flow in our markets. I would keep an eye on any policy making, whether federal, state or regional, that will broaden the opportunities for stationary fuel cells like ours. With solar, once California moved their program from an \$80 million program to their \$3 billion program, a lot of companies jumped in and the solar stocks really went far. Then it's cost reduction to open the broad markets. Ultimately, the buyer of the product will be utilities, and we expect this to begin to happen in Connecticut, where they are moving to use this solution to help support grid areas where it's just too costly and time consuming to install new central generation with new transmission and distribution infrastructure.

TWST: What is it that you feel compels investors to include FCEL as part of their current portfolios and as part of their longer-term investment strategies?

Mr. Mahler: Global markets for clean superior energy are exploding, and that's why you see increased activity with wind and solar. Fuel cells with their 24/7 ultra-clean attributes will capture its fair share of that marketplace. If you look at just the renewable portfolio standard markets in the United States, there are 22 states that have these standards. There are over 25,000 megawatts of renewable/ultra-clean power that ultimately needs to be installed. While solar can capture a portion of that, it leaves the entire 24/7 piece of the pie. Right now, we are probably the best product in the world to do that. I think there is a very big and exciting opportunity here.

We believe that we can continue to get our product cost to keep opening broader and broader markets for our products, so we can capture not only these renewable portfolio standard markets, but we can also capture what we call the onsite market. The onsite market is where you

have hotels, universities, and other commercial and industrial locations that have 24/7 load factors, that for reliability and cost management reasons want to generate some of their power themselves.

We think we are the first mover in the industry. We are seeing increasing opportunities to expand this business. It's been a long time coming, but now we have a path to put tens and 100s of megawatts on an annual basis into service globally.

TWST: Are there any other thoughts or issues to include, such as intellectual property?

Mr. Mahler: From an intellectual property standpoint, we have very strong patents. I think we have over 100 international patents. So intellectual property-wise, we are very strong. There aren't that many competitors directly to us at this point in time, so I think that's pretty good.

One thing we really didn't go through is who our customers are and who is buying our fuel cells. We have two levels of that. One is an excellent distribution network including POSCO Power in South Korea, Marubeni in Japan. Caterpillar, Chevron, Alliance Energy and Logan Energy, among others. We have Enbridge in Canada, which is actually developing a slightly different product for us. They are developing a pipeline product that uses the heat from the fuel cell to prevent natural gas from freezing when it goes from a high-pressure pipeline to lower pressure for street level distribution. At the same time, they will be able to sell electricity as a commodity that gives them an opportunity for return on investment.

We have a global customer presence that includes wastewater treatment plants like Santa Barbara in California, the city of Fukuoka in Japan, and breweries at Kirin and at Sierra Nevada. We have large company customers such as Epson and Sharp in Japan, Pepperidge Farm in Connecticut, Michelin in Germany, Tokyo Gas and multiple Starwood Hotel locations. We have universities including Cal State-Northridge, Yale, Chosun University, Pohang University, Ocean County College in New Jersey and Grand Valley State University. We have multiple hospitals. It's a great application for hospitals. We can think that every hospital in the world should have a fuel cell. We have governmental and institutional customers such as Camp Pendleton, the San Francisco Mail Processing Center and the Santa Rita Correction Facility. As you can see, we have a broad range of customers that really like the product.

TWST: Thank you.

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