



LIQTECH INTERNATIONAL, INC.
(NASDAQ: LIQT)

LIQTECH

**FIRST QUARTER FISCAL YEAR 2020
FINANCIAL RESULTS CONFERENCE CALL**

Monday, May 11, 2020
9:00 a.m. Eastern

CORPORATE PARTICIPANTS

Sune Mathiesen - Chief Executive Officer, LiqTech International, Inc.
Robert Blum - Managing Partner, Lytham Partners, LLC

PRESENTATION

Operator

Thank you very much, Kate. Hello, everyone, and thank you for joining us today to discuss LiqTech International's first quarter 2020 financial results. I'm Robert Blum of Lytham Partners. I will be your moderator for today's call.

Joining us on today's call from the company is Sune Mathiesen, the company's Chief Executive Officer. Before I turn the call over to Sune, let me remind listeners that following the conference call there will be an open Q&A session. You should also note that a replay of this call will be available shortly following the conclusion of the live call, and that a transcript of the call will be available on the Investor Relations section of the company's website.

Before we begin with prepared remarks, we submit for the record the following statements. This conference call may contain forward-looking statements. Although the forward-looking statements reflect the good faith and judgment of management, forward-looking statements are inherently subject to known and unknown risks and uncertainties that may cause actual results to be materially different from those discussed during the conference call.

The company, therefore, urges all listeners to carefully review and consider the various disclosures made in the reports filed with the Securities and Exchange Commission, including risk factors that attempt to advise interested parties of the risks that may affect our business, financial conditions and sales of operations and cash flows. If one or more of these risks or uncertainties materialize or if the underlying assumptions prove incorrect, the company's actual results may vary materially from those expected or projected.

The company, therefore, urges all listeners not to place undue reliance on these forward-looking statements, which speak only as of this date and the date of the release and conference call. The company assumes no obligation to update any forward-looking statements in order to reflect any events or circumstances that may arise after the date of this release and conference call.

With that said, I would like to turn the call over to Sune Mathiesen, Chief Executive Officer of LiqTech International. Sune, pleased proceed.

Sune Mathiesen

Thank you, Robert and good morning to all of you. Thank you for joining us today to discuss our first quarter 2020 financial results.

We hope everyone on the call and your families are safe and healthy. The COVID-19 pandemic has certainly made the past months challenging, but our situation in Denmark is now slowly, but safely normalizing and we are seeing the first signs of activity improving in the market. I will get back to this a little bit later.

Our first quarter results were in line with the preliminary expectations we discussed with you during our March 26 conference call, with yet another record revenue quarter for the business of \$10.3 million despite the negative impact from COVID-19, which impacted deliveries in the final weeks of the quarter.

As we discussed, we were on track to deliver approximately \$12 million for the first quarter when COVID-19 began to disrupt operations. The \$10.3 million we achieved represents a 39% increase from the first quarter a year ago and was due to the highest savings of our proprietary ceramic silicon carbide water filtration systems for the marine scrubber market, where we continue to achieve a significant commercial breakthrough.

We also remained profitable, although not at the level that we might normally expect as our cost structure for the first quarter was designed to meet both the higher revenue expectations we originally had prior to COVID-19, but also our expectations for continued ramp in the business going into the second quarter. I will talk about our outlook for the second quarter and beyond momentarily.

We also made very good operational progress since the first of the year. We successfully installed the first of the brand new, customized furnaces around the first of the year, and recently completed installation of the second new customized furnace for use in the manufacture of the Company's proprietary silicon carbide membrane filters.

Each of the furnaces have throughputs that are approximately four times higher than the older furnaces due to size and efficiency. We are planning to install two additional new furnaces by the third quarter 2020, which upon successful installation of all four, increases the Company's total capacity to be between \$150 and \$200 million on an annualized basis by mid-2020.

As we mentioned in the press release, we incurred approximately \$200,000 of incremental costs during the first quarter related to the ramp in manufacturing. As the additional furnaces come on board, these amounts will decrease as our knowhow improves.



We improved our overall gross margin to 25.7% in the first quarter. The improvement was primarily driven by deliveries of our MK6.1 system, which we launched in the third quarter last year. The MK6.1 system is a lower cost, and more efficient system. When you break out the contribution margin by systems, the MK6.1 had contribution margins of more than 40% during the quarter, as compared to the older MK6 systems which had contribution margins of approximately 25%. Of the \$7.9 million of marine revenue during the first quarter, about two-thirds was on the older, lower margin systems, and one third was on the newer, higher margin systems. We have now worked through all orders for the old lower margin MK6 systems, and all future systems set for delivery will be MK6.1 systems or higher, which should further drive improvement in gross margins overall going forward.

When the impact from COVID-19 first began to occur, we implemented several measures to ensure manufacturing continuity and adhere to strict state guidelines on the number of personnel that can work in proximity. We divided the workforce into multiple shifts and had certain office people work remotely from home.

Since the end of April, Denmark has relaxed its guidelines and employees have now returned to more normalized operating procedures. We were also proactive in restructuring our overall cost base given the expected near-term impact to the business. Overall, we have a path in place to reduce our annual cost base by approximately \$1.9 million, which will be phased in over the next several months. Our hope is that we are able to quickly ramp back up to full capacity, but given the current uncertainty, these moves allow us to create a cost structure whereby we can be profitable at about \$7 million per quarter in revenue. We continue to monitor the current situation and we are prepared to implement further plans to reduce costs if necessary.

As I mentioned back at the end of March during our year-end call, due to the impact from COVID-19, the rate of incoming orders for the marine scrubber industry has slowed and will likely impact the second and third quarter revenues. We are currently working through and delivering orders received earlier in the year, but with the slowdown in orders and difficulties in delivering and commissioning systems, this will translate into a slowdown in deliveries this and next quarter.

What I can share with you is the following, we are now back in full manufacturing in Denmark. Unfortunately, this is not the same case in many other countries around the world and I want to emphasize that our lack of visibility for the next two quarters is not due to our inability to manufacture product, but based on customers being able to receive product.

We are currently in discussion on more than 70 marine systems orders, which would be delivered commencing later this year and beyond. This is a strong number that represents roughly \$30 million in sales and based on our historical conversion cycles, I expect this to receive the vast majority of these orders. While there has certainly been a slow-down in orders that started in Asia, and gradually worked their way to Europe, customers around the world seem to be slowly coming back and the recent improvement in activity gives us reason to believe that our business will soon return to normal levels.

I want to give you an update on our progress in the Oil and Gas markets before I turn it back over to your questions.

At a high level, the capabilities we have developed, using our proprietary ceramic silicon carbide filters in our unique systems design, are applicable to a number of applications.



We had our first commercial breakthrough of the technology in the marine scrubber segment, and we continue to believe this will be a significant growth driver for our business. We have also made inroads in the power plant market, particularly in parts of Europe where similar regulations are limiting the discharge capabilities from these plants.

The next application we are commercializing is the oil and gas market, one that we believe will significantly surpass both of the other markets in terms of their overall size for LiqTech in the years to come.

What makes LiqTech's solution unique for this market is our ability to treat difficult water and reuse it in the process. We have tested our technology together with some of the largest Oil and Gas companies and we have proven that our technology offers a better solution in terms of both quality and cost compared to existing alternatives in the market.

As earlier discussed, we have been maturing several projects in the Middle East for some time. These projects are for water reuse in the oil production and related to water scarcity in the region. So despite of the varying price of oil in any given period, these projects are focused on long-term solutions to long-term issues. This is why we think, that our technology is ideally positioned to address the need for water treatment solutions to areas in the Middle East where there is local water scarcity. We look forward to finalizing contracts in the months and years to come, with an expectation that the oil and gas market will be the largest contributor of revenue in 2021, and want to once again note, this is not because the marine scrubber business will see a drop off, but because the oil and gas opportunity is simply that large.

So just to wrap things up before we turn it over to your questions, I want to say, that I am pleased with the operational performance by the team over the last number of months. We finished the first quarter with record revenues, despite the impact from COVID-19 mid-way through Q1 and maintained profitability in the business. The management team has quickly navigated the COVID-19 disruptions, ensuring manufacturing continuity, while at the same time ensuring our cost structure matches our revenue levels in the near-term and lowering our overall breakeven point.

We continue to make progress in oil and gas markets, which follows successful pilot programs with key customers in the region and we believe that we are on track to announce significant orders for this industry in the near-term, and despite the impact from COVID-19, we remain the leader in the marine scrubber industry for filtration. We believe our market share remains in the 50% range, and while there was a lull of orders given the global disruptions, activity is once again picking up with us currently bidding on more than 70 orders, which we believe will translate to a return to our historical levels of growth later this year.

One final note, I will be participating in a virtual investor conference presentation next week, Wednesday, May 20th with the team at Lytham Partners. Details on the webcast will be sent out later this week, and I will also be participating in virtual 1x1 meetings on Thursday, May 21st. Please contact Robert Blum for additional information, and with that said, let me now turn the call over to any questions you might have. Operator, please?



QUESTIONS AND ANSWERS

Operator

We will now begin the question-and-answer session.

To ask a question, you may press star (*) then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, press star (*) then two (2). At this time, we will pause momentarily to assemble our roster.

Our first question is from Eric Stine from Craig-Hallum. Go ahead.

Eric Stine

Hi, Sune.

Sune Mathiesen

Morning, Eric.

Eric Stine

Morning. So, you've touched on it and obviously, things have slowed down, but I'd love to hear your thoughts just on the overall market and obviously there's been -- at least here near-term because of the spread -- a pretty widening or lengthening out of paybacks for scrubbers, what you're hearing from customers, whether you or if they are saying they think that's a little bit more of a long-term situation, or is that truly a couple quarters?

Sune Mathiesen

So, what we hear from our customers is that they are not really focused on, let's say, the spread in any given time. They're more focused on the long-term spread between low sulfur and the bunker fuel. We see that now -- it has truly been quiet for some months. In the beginning of the COVID-19 situation, I'm very pleased to see that in the last, I'll say, two or three weeks, we have seen a significant take off in activity from the scrubber manufacturers and from the ship-owners. So, it looks like things are now normalizing, we see the oil is coming off a little bit again, the price spread is coming up and it looks like they are now continuing with, let's say, the scrubber installation plans that they had already before the COVID-19 situation. So, we think it is a couple of months of disruption, and, especially what we've seen in the last couple of weeks leads us to believe that the situation is now normalizing. We're not completely back to normal, but as I mentioned, we are negotiating a significant number of new contracts, and so, that is a very positive sign for us.

Eric Stine

Yeah, and when you talk about those new contracts, it's still a similar dynamic as what a month and a half ago when it was more activity out of China rather than Europe, or I mean, it's some of that renewed activity Europe?

Sune Mathiesen

In the past couple of weeks, we now see more activity again from Europe. Two weeks ago, three weeks ago, it was completely dead from Europe, and it was driven by the Asia players who've been back to work for a while now, but now we see the European players are coming back, which is a great sign. So, again, things are normalizing in Europe and I think, there is still a lot of challenges in southern part of Europe, but in northern Europe things are slowly, but safely normalizing and we see that activity is picking up.

Eric Stine

Got it. Thanks for that, and then maybe just the backlog, and I know you don't quote the backlog, but maybe if you could just talk about the health of that a little bit, are you seeing -- or have there been any cancellations, or is it more a case of what you've got in backlog? Just being pushed to the right in terms of timing.

Sune Mathiesen

We have actually not seen a single cancellation. We have seen issues in delivering products, issues in commissioning systems over delivered, but we have not seeing any cancellations. So, again, a great sign, and it leads us to believe that this is more of a timing issue more than anything and that things will come back and obviously, we are encouraged to see that there has been no cancellations at all.

Eric Stine

Yeah. Absolutely. Maybe the last one for me, just on the OpEx, could you just give some of the specific actions that you're taking there? And then just curious, you mentioned last quarter that there might be some help from the Danish government. I think, it was something like \$400,000 a quarter. Whether that is something that you have chosen to, or are able to access? Thanks.

Sune Mathiesen

Yeah. There are a number of initiatives from the Danish government. You can send people home and have salaries refunded or partly refunded, and there's also an initiative that you can delay tax payments for four months. We have chosen to use the delay of the tax payments, which will help liquidity in the next four months. We have not chosen to use the initiatives to reimburse part of the salaries for employees, because for our employees, the percentage was too low. So, the cost savings that we have now put in place is that we have laid off a number of people to reduce our overall costs. We have tried to be careful in the layoffs. So, they are people in the manufacturing, they are people working with project management. We have not made any reductions in R&D and let's say, longer term important functions.

The Danish situation is little bit different. It's not like in the U.S. when you lay off people, they go home the next day. We often have three, four or five months of termination periods, so, these employees are currently working through their termination periods, which is why the cost reductions will come in to real force by August of this year.

Eric Stine

Okay. Thanks a lot.

Sune Mathiesen

Thanks, Eric.



Operator

Our next question is from Robert McCarthy from Stephens. Go ahead.

Robert McCarthy

Yes. Good afternoon and good morning. Sune, how are you today?

Sune Mathiesen

Morning Robert. Good. How are you?

Robert McCarthy

Good. So, appreciate all the color. Definitely a lot to noodle on. Asking around the cash burn, it looks like, obviously, working capital, it's a good news story and the fact that you're expanding working capital to meet demand, but how do we think about your cash balance right now and your cash burn going forward? And would you anticipate any needs for additional funding, or do you think just given the fact that you're going to have these cost saves and ramping up production that cash generation is going to take care of itself?

Because obviously, I think, last time we spoke on the quarterly call, you suggested that obviously if activity would want more of, and you definitely had a long runway here, but given the fact that you're going to have some fits and starts with your working capital and your supply chain, your productive chain, how do we think about what your cash position could be kind of going into 2021 and beyond?

Sune Mathiesen

Yeah. So, the steps we've taken right now to reduce our overall cost base means that we should be profitable on approximately \$7 million of revenue per quarter. So, we are definitely cautious here. We have taken, I think, the light steps to reduce our overall cost base, and it means that we shouldn't burn too much cash due to this COVID-19 situation.

Secondly, we saw our cash balance come down in the first quarter, but that was really a result of the increased level of business, the record revenues in the first quarter, which required more working capital. After the quarter ended, we have started collecting some of these payments on goods delivered in the first quarter, and our cash balance today is somewhat higher than it was ending the quarter.

So, I think, we're in good shape here. We have no debt. We have to pay our cash balance, and we have taken steps to reduce our overall cost base to match revenues in this difficult COVID-19 situation, and we are now seeing signs of the business improving. We are seeing more RFQs, we are seeing more orders again, and that leads us to believe that by the end of this year, hopefully, we'll be back, let's say, where we were before this COVID-19 situation.

Robert McCarthy

In terms of your backlog, I think, you suggested, obviously, given the mix shift to the better the MK6, I believe, in terms of the product profitability, you expect 40% contribution margins versus your historical 25% for your existing product lines. So, we should expect, all things being equal, a pretty nice lift in gross margins in the back half of the year or into 2021, correct?



Sune Mathiesen

That is correct. So, very encouraging to see the development in the first quarter. About one-third of the deliveries was the higher margin MK6.1 product. Two-thirds was the old lower margin MK6 product. We have now worked through all the MK6 orders we had in our pipeline, all future deliveries will be MK6.1 or higher, and that also means that we'll see further improvement in the gross margins, which I'm very pleased to see.

Robert McCarthy

And then what's the state of your tax credit right now in terms of what's going on? Remind us, how that is going to work, particularly as you start to ramp and start to make some money here -- how much of a tax advance do you get over the next couple of years?

Sune Mathiesen

Yeah, we have -- I think, it's all together about \$6 million tax advance, and that we are now starting to activate. We were nicely profitable in the Danish entities last year, and we used some of that tax assets and so, we're not paying tax, and that will continue in the years to come.

Robert McCarthy

So, final question. The third quarter, I think, is traditionally a period where you'd start to see some just easing in production, just given the seasonal activity of production in Europe and Scandinavia, right? Do you expect, just given the disruptions we've seen, whether you'll be full bore in the third quarter, or do you think you'll see the same seasonal production patterns?

Sune Mathiesen

So, one of the good things that came out of the COVID-19 situation is that we burned through a lot of the holiday allowance for the employees. So, in theory, if we see activity pick up in the market and the customers being able to accept deliveries, then we will be able to be more access than normal in the holiday season, but again we are now seeing the first signs of the market recalling after COVID-19, it is still challenging, and I believe that our revenues will be impacted for the second quarter and the third quarter. To which extent is still difficult to predict, we are bagging full manufacturing and so, it all comes down to our customers' ability to actually accept products.

So, yes, in theory, we will be able to have more people working through the holiday season, because they already took out some of their holidays at this point.

Robert McCarthy

I'm sorry. Just one more. Diesel particulate sales in your business for the quarter and for the -- what's your expectation for the full year? Just so we level set expectations.

Sune Mathiesen

Yeah. DPF, we have not really any changes to our expectations. We still think it will be between \$6 [million] to \$8 million for the year, and for the quarter, it was pretty stable. I believe it was around \$1.5 million.

Robert McCarthy

\$1.5 million? Okay. Thank you, Sune.

Sune Mathiesen

Yeah. Yeah. Thanks.

Operator

Again, if you have a question, please press star (*) then one (1).

Our next question is from Rob Brown from Lake Street Capital Markets. Go ahead.

Rob Brown

Just on timing of shipments and recovery and things recovering, how many units do you have sort of built, ready-to-go at this point, or sense of how quickly things can turn back on?

Sune Mathiesen

We have not discussed that, but we have stated full manufacturing. So, we do have a fair amount of systems that are ready-to-go, and it also means that when things pick up again, we will be able to ship products very quickly.

Rob Brown

Okay, and then the oil and gas market, you talked about a significant ramp into next year, when do you need to see order activity start to hit your goal of being larger part of the business next year?

Sune Mathiesen

We think that the second and third quarters will see first orders from the oil and gas industry. In fact, we have great confidence in that. We have been working on it for a long time now. We talked about it for last six months now, and there are no changes. The projects in the Middle East are related to water scarcity and so, they are moving forward despite of, let's say the outswings in oil prices that we have seen in the last couple of months. So, we are encouraged to see that we're still making progress in that, and we would expect to see first orders in the next few months.

Rob Brown

Okay, and it's a little surprising that the oil and gas business given the CapEx cuts in that world, they're still moving forward with sort of the cap project. Have you gotten recent checks there that are saying that the things are moving forward, or is this a case of the customer base that you're talking about? Just give us a sense of why those projects can still move forward in the tough commodity environment?

Sune Mathiesen

Yeah. We are in contact with these customers almost on a daily basis. Things are moving forward, and I would say, yes, it is surprising in the current environment in the oil and gas business, but again, these projects are not related to anything other than water scarcity, and so, they simply do not have any water, and if they want to continue to manufacture oil, they need to do something otherwise – otherwise, they will be in need of water. What they are doing today is trucking diesel made of water, which obviously comes with a huge cost. So, even despite of the oil prices that we have today, this really represents a great opportunity for the operators to cut their costs on water used in the process.

Rob Brown

Okay. Great. Thank you so much. We'll turn it over.



CONCLUSION

Operator

This concludes our question-and-answer session. There are no more questions. I would now like to turn the conference back over to Sune Mathiesen for closing remarks. Go ahead.

Sune Mathiesen

Thank you, operator and thanks for everyone joining us on the call today. I look forward to speaking with many of you again next during our virtual presentation and one-on-ones and hope that we can all visit face-to-face again in the near future. Have a good day and stay safe.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.