



LIQTECH INTERNATIONAL, INC.
(NASDAQ: LIQT)



SECOND QUARTER FISCAL YEAR 2019
FINANCIAL RESULTS CONFERENCE CALL

Wednesday, August 14, 2019
9:00 a.m. Eastern

CORPORATE PARTICIPANTS

Robert Blum - Lytham Partners, LLC, Managing Partner
Sune Mathiesen - LiqTech International, CEO

PRESENTATION

Operator

Good morning, and welcome to the LiqTech Second Quarter Fiscal Year 2019 Financial Results Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then one on your touchtone phone. To withdraw your question, please press star, then two. Please note today's event is being recorded.

I would now like to turn the conference over to Robert Blum with Lytham Partners. Please go ahead, sir.

Robert Blum

Thanks so much, Rocco. Good morning, everyone, and thank you for joining us today LiqTech discusses its second quarter 2019 financial results. I am 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 today's call will be available shortly following the conclusion of the live event and that a transcript of the call will be available on the Investor Relations' section of the company's website shortly thereafter.

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 condition, 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.

Now, I'd like to turn the call over to Sune Mathiesen, Chief Executive Officer of LiqTech International. Sune, pleased proceed.

Sune Mathiesen

Thank you very much, Robert, and good morning to all of you. Thank you for joining us today to discuss our second quarter 2019 results. I believe that we're reporting strong quarter and I'm excited to be speaking with you today.

The second quarter financial results continue to highlight the strong demand for our proprietary ceramic silicon carbide water filtration systems as the leading solution for closed-loop marine scrubber applications. The second quarter was again a new record for the company. The revenue was \$9.3 million and exceeded the expectations we shared back in May and we also accelerated our profitability. The revenue of \$9.3 million was up 258% from the same period in 2018 and up 25% sequentially from the first quarter of 2019. We are clearly gaining significant market traction and our market share continues to grow.

In addition to the significant growth in revenue, we also improved profitability with income from operations of \$393,000 compared to an income from operations loss of \$563,000 in the second quarter last year. On a sequential basis, we significantly improved profitability as well. We continue to make progress on leveraging our cost infrastructure and our contribution margins for our marine scrubber products improved more than 500 basis points in the second quarter. I'll go more into details on our margin optimization program shortly.

Our overall gross margins in the quarter was positively impacted by the 500 basis point improvement in contribution margins from our marine scrubber products. But it was also partly offset by those things of DPF products in the quarter resulting in low overhead absorption. We do expect DPF sales to normalize in the coming quarters and we expect further improvement in contribution margins from our marine scrubber products.

Finally, due to the increases in profitability and proceeds from an over-subscribed public offering in May 2019, our balance sheet is in the best position it has ever been. We are certainly very appreciative of the support we have received from investors.



While we have even yet to hit the January 1, 2020, date for IMO 2020, the market is quickly evolving. A number of new scrubber manufacturers have entered the space. However, we have not seen any significant new entrants in the filtration component of this market--the area in which LiqTech operates.

We designed LiqTech's marine scrubber filtration technology as a plug-and-play solution, allowing for it easily to be integrated into a variety of scrubber systems sold in the market. As the scrubber market has expanded and an increasing number of scrubber manufacturers have entered the space, we have successfully increased our customer base and diversified our geographic footprint to drive growth and maintain improved market share. The biggest new entrant to the scrubber manufacture site has confirmation [ph]. We have very good relationships with the Asian manufacturers and today a large proportion of our current backlog is from Asian players, compared to just a small percentage a year ago. Overall, we are now supplying filtration systems to a large number of scrubber manufacturers with two new customers added in just the last quarter.

We know there's been news in the market about certain companies highlighting headwinds for their products. We believe this is a function more of the increased competition as opposed to a pullback in demand for scrubber solutions. While we continue to see increasing demand for scrubbers as a whole, we are also seeing increasing movement towards closed-loop systems, which include filtration components. Enhancing this demand is continued tightening of global legislations to ban discharge from open-loop scrubbers in many of the world's most important ports, including recent movements by China to further implement new discharge limits on PAH and oils, which our silicon carbide filtration system helps to address.

We believe the installation and conversion to closed-loop systems will continue to increase as a percentage of overall installations in the future, representing a large and increasing market for our solutions. By the end of this year, we estimate that more than 4,000 open-loop scrubbers would be installed or on order rather sending in large potential upgrade market for us for open-loop conversions. In our opinion, the current economic argument still strongly supports marine scrubbers. The current spread between heavy fuel oil and low sulfur diesel continues to offer very attractive return on investment on scrubber installations. Analysts following the industry believe that the current spread is likely to widen [indiscernible] at same level.

We know the backlog and customer order commitments are important factors that many of you are looking at. As we continue to grow and are now in the process of delivering systems to the market, while at the same time diversifying our product offerings, we have discussed with many of our investors the best ways for us to communicate key metrics on the progress in the business. The consensus was for us to provide the book-to-bill ratio. Our book-to-bill ratio in the second quarter was 1.6 and again this highlights improvements from our most recent conference call in securing new customers and building our backlog.

The company's margin optimization program remains on target, as most of you that were at our Analyst Day and listened online heard efforts to eliminate costs, streamline processes, in-source certain manufacturing benefit from economies of scale and implementing manufacturing all [indiscernible].

As earlier mentioned, contribution margins from our marine scrubber products improved more than 500 basis points in the second quarter. We're very pleased with this progress and we expect further significant improvements in the second half of 2019, especially from certain design changes to our product and in-sourcing of currently outsourced manufacturing.



Additionally, the planned expansion in manufacturing operations remains on track with the first of the new furnaces for the expansion of our Ballerup facility said to be delivered in the third quarter 2019, and a planned expansion in Hobro also said to be completed in the third quarter 2019. Overall, we are on target to triple our manufacturing capacity by July 2020.

Again, as many of you heard during our Analyst Day a few months ago, while we remain highly focused on the scrubber market, there are a number of opportunities to expand our proprietary technologies to adjacent technologies and applications. The continuous progress—the adoption of our ceramic silicon carbide filtration technology to the power plant market. We've already booked several orders in 2019 and have been specified for a number of projects into 2020. Again tightening legislation within many countries is driving the need from water treatment systems for power plants. We expect meaningful revenue in 2020 from this area.

Additionally, our silicon carbide diesel particulate filters, a product we have been manufacturing for nearly 20 years, is ideally suited to address NOx reduction within the marine industry. I highlighted this point during our Analyst Day but just reiterate the NOx emissions from one large cruise ship is equivalent to 421,000 passenger cars. As a result, we along with many others in the industry anticipate tightening the inflation for NOx in the near future. We remain on target to launch the product in 2020.

Finally, we also anticipate introducing other products adjacent to the marine scrubber market on a standalone basis, including an in-port water treatment system that will allow ship owners with an open-loop scrubber to operate auxiliary engines while in port and a filter press that is also a component of our existing systems, further enhancing our reach within the market.

We also advancing OEM membranes; originally that is what LiqTech was focused on. However, lack of interest from water treatment OEMs originally forced us to become a systems integrator in 2014. However, following the current success in the marine scrubber industry and successful large gain references in other industries, we are now experiencing great interest from water treatment OEMs. We expect membrane sales and licensing agreements to be a significant part of our business in the future. Don't forget that membranes carry attractive growth margins that will further improve our overall margin structure. So, while we are highly focused on the marine scrubber filtration systems, we also focused on diversifying and expanding our addressable market opportunities.

I mentioned this earlier, but I think it bears repeating, transitioning a business from concept to product development to full commercialization is never easy. However, the team at LiqTech has done an extraordinary job in meeting the increasing demand for our products. I appreciate the hard work and dedication from everyone in LiqTech.

So, before I turn the call over to your questions, let me just say that we are extremely pleased with the progress made to position LiqTech as the market leader in the marine scrubber filtration business. We believe the addressable market opportunity will continue to increase driven by evolving legislation and simply better business case economics. From a manufacturing standpoint, we are on track with respect to our margin optimization program, which should continue to give incremental sequential gains in the quarters to come.

Lastly, we have a number of new products set to hit the market in 2020 that should drive continued growth and diversification of our business going forward. With that said, let me now turn the call over to any questions you might have. Operator, please?



QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. To ask a question, you may press star, then one on your touchtone phone. If you're using a speakerphone, we ask that you please pick up your handset before pressing the keys. To withdraw your question, please press star, then two.

Today's first question comes from Eric Stine of Craig-Hallum. Please go ahead.

Eric Stine

Hi, Sune. Good morning. Maybe I'll start with just a marketing question. I know it's not widespread but you're starting to see, I guess, Singapore would be the best example saying that they're going to be purposefully lax in enforcement early in 2020. Just curious if you think that's a one-off, if that has any teeth, and are you seeing any pause in the market as a result?

Sune Mathiesen

We're not. We see continued growth in the market. I think the book-to-bill ratio of 1.6 really proves that, even though we had a record revenue quarter, we booked 60% more than we shipped. And so we are not seeing any pauses. We, on the contrary, see continued growth in the market. And it looks like that will continue in the second half of this year as well.

Eric Stine

Got it. Maybe just turning to the two new scrubber customers, I'm wondering, I mean given your commentary, is it fair to say that those are Asian customers? And maybe if you could just characterize them? And just curious if they were a component of your Q2 order strength.

Sune Mathiesen

Yes. They were a component of our order strength; they were not Asian; however, they were actually European players. We saw a lot of new Asian players come into the market in the second half of 2018. And we've seen a lot of players coming in the first half of 2019 as well. But in this specific quarter it was actually two new European players.

Eric Stine

Got it. And I know in the past you've said that you count seven of the top ten as customers. I mean how would you characterize these customers. I mean are they on that top ten list or are they more in the up-and-comer category?

Sune Mathiesen

They are more in the around ten spots, so pushing to get into the top ten but not in the top ten.

Eric Stine

Got it, okay. Last one for me just as we think about this going forward, I mean I would think especially in light of your backlog, is it fair to think, I know, in the past you've talked about sequential growth throughout the year and obviously strength heading into 2020, is that still the expectation that there should be a step up here in revenue for 3Q?

Sune Mathiesen

Yes. We definitely feel we had a very strong start to the year. We had a record first quarter, record second quarter, record first six months, but we think definitely that the second half of 2019 will be stronger than the first half.

Eric Stine

Okay, thanks.

Operator

Our next question today comes from Robert McCarthy of Stephens. Please go ahead.

Robert McCarthy

Good morning. How are you, sir?

Sune Mathiesen

Good morning. Very well. How are you?

Robert McCarthy

Very well. So, let's just talk about the book-to-bill first. I mean, the suggestion of, I think your average content on a scrubber is in that \$500,000 range, one could surmise that the shipments in the quarter on the marine vessel side could be as high as the 17 or 18 range which would imply apply a book-to-bill order strength of about high 20s. I think that would indicate backlog growth for you of probably mid-single-digits for the second quarter. Is that a fair characterization or am I doing the math wrong?

Sune Mathiesen

Yes. So, we shipped about—our marine scrubber business in the first quarter was about \$8.3 million, \$8.4 million of revenue. So, we booked 60% more than that.

Robert McCarthy

Understood, okay. Well, I will pursue that line of questioning offline. Then I guess the next thing is just maybe in terms of following up with some of Eric's solid questioning, could you characterize what you're seeing that's different in the market? And I guess it would be around the increased adoption of closed-loop scrubbers and the related technology. But obviously [indiscernible], others did talk about a precipitous drop in orders, but obviously that was due to some compares and also the fact that as we get closer to compliance and longer lead times there could be kind of a strategic pause for open-loop scrubbers. Could you just take this opportunity to kind of expand on your comments why you think you're going to just grow a lot better and you're more disconnected from what their comments are?

Sune Mathiesen

Yes. I think if we take those two, and it's correct that they said that they have seen a softening in scrubber demand, and I think it relates to two things. One fact is that they used to have a very, very high market share. I can go 12, 24 months back, there was a limited number of players in the industry and these two guys probably had 25%, 30% market share each. What we've seen over the last 12 months is it's a huge number of new players in the industry with some South Korean players, a lot of Chinese players coming into the industry. We've seen new European players come into the industry. And I think what they are experiencing is that they are losing market share.



And so, we actually think the overall scrubber market is unchanged or still growing. What we are also seeing is a larger proportion of closed-loop companies and we think the market is moving slowly but safely from open-loop systems to higher-driven closed-loop systems, obviously benefiting our business.

Robert McCarthy

Yes, and your core profitability was very strong as were contribution margins. Obviously, I think FX moved against you and I think you think that will reverse in the second half. Maybe you could talk about in that context the margin enhancement, some of the initiatives there, and I think one thing that was suggested in the past was obviously more in-sourcing occurring. So, I wanted to get any kind of qualitative update on that ability to in-source, because obviously that's going to have potentially very profound impacts on your gross margin.

Sune Mathiesen

That's correct. So, we made a good improvement in the second quarter and improved more than 500 basis points on our marine scrubber margins and that was really due to optimizations in-house. What we'll see in the third and fourth quarters is in-sourcing of currently outsourced manufacturing is one component and that will be a big driver for margin optimization. And we are doing certain design changes as well that we're implementing in this current quarter and that would also improve our margins. So even though we made significant improvements in the second quarter, we are expecting significant improvements again in the third and fourth quarters.

Robert McCarthy

Finally, if you'll indulge me, the diesel particulate sales in the quarter, I don't know if you called out how much that was in actual dollar basis and then obviously power plant, excuse me, revenues in association with diesel particulate and then any of the power revenues. I don't know if you disclosed that or not.

Sune Mathiesen

We do not disclose that yet and I think it will be meaningful to start disclosing that when we get into 2020. We're doing very well on booking orders in the power plant site and we think it will be a meaningful part of our revenue stream in 2020.

Coming back to the diesel particulate filters, it's correct that we had a very weak quarter for diesel particulate filters. We had revenues, and let me check so I am accurate, we had revenue of about \$700,000 in the second quarter of these particulate filters, which is exceptionally low. If we take the first half of the year, it's all together about \$3 million of revenue, which is a normal level for us. And we're expecting to see a normalized level but again in the third and fourth quarters.

So, it was an exceptional quarter for the diesel particulate filters, which will normalize in this quarter. But unfortunately, it also means that we had lower absorption of overhead and it kind of hit the overall gross margin. So, we are pleased with the improvements on the marine scrubber business and we know that diesel particulate filter sales will normalize in the third quarter.

Robert McCarthy

And conversely, obviously the implied revenues in association with marine, at least by my expectation, are going up on the basis of that, right. So that's probably a net positive in terms of the growth. So, with that I'll leave it and get back into queue and I look forward to seeing you soon.



Sune Mathiesen

Sounds great. Thank you.

Operator

And our next question today comes from Rob Brown of Lake Street Capital Markets. Please go ahead.

Rob Brown

Hi, Sune. On the closed-loop scrubber market what's sort of the penetration rate of new orders at this point and how do you see that playing out into 2020?

Sune Mathiesen

So, what we're missing at this stage is feedback from the scrubber manufacturers. Our sense of what is going on is that we see a larger part of scrubber installations being closed-loop now. We have seen, especially China, has been very aggressive in legislation. They've come out and said they want to implement further legislation and ban open-loop discharge, but also implement new legislation and discharge limits on PAH, on oils, and so forth.

We think this is a trend. We think we'll see more and more ports around the world ban open-loop discharge and we think eventually we'll see a global ban against the open-loop discharge. And I think a lot of ship owners are seeing this right now and our sense right now is that a larger proportion of the scrubber installations and especially planned scrubber installations are closed-loop versus open-loop.

Rob Brown

Okay, great. Then on the power plant market, you talked about a couple projects you've won and some activity this year that leads into next year. But what's sort of the average kind of revenue per project and what markets are you seeing activity in?

Sune Mathiesen

So, we started back home in Denmark a few years back on power plants and it was really good to see that we got traction. We did a number of power plants in Denmark so far, and we kind of expanded our view into Europe. We recently completed a \$1.1 million installation in Finland, and we plan to expand into Germany, Sweden, Finland, and Norway. So, let's say countries near to Denmark will be the first countries we are targeting. We're booking orders right now and again we think it would be a more meaningful part of our revenue in 2020.

Rob Brown

Okay, great. Thanks for the color. And then lastly on the framework agreement, the third framework agreement that you're working on, where are you at in terms of order flow there and thinking on how that ramps?

Sune Mathiesen

Still early stages. We said for a while that we think this will turn into meaningful revenue from beginning of 2020, and that should still be true.

Rob Brown

Okay, thank you. I'll turn it over.



**Operator**

And, ladies and gentlemen, as a reminder, if you would like to ask a question, please press star, then one at this time.

Today's next question comes from Liam Burke of B. Riley FBR. Please go ahead.

Liam Burke

Thank you. Hi, Sune. How are you today?

Sune Mathiesen

Doing well. How are you today?

Liam Burke

Fine. Thank you. You talked about the scrubber market. You talked about legislation. Do you view, you don't have to give me a specific number, but do you view the overall demand for scrubbers changing either upward or downward to the original base case you made when you entered the filtration market?

Sune Mathiesen

Really unchanged. We had high expectations for scrubber adoption. We predicted about 20% uptick in scrubbers by 2025. And so far, that prediction has been pretty accurate. So, we had high ambitions and so far they proved correct.

Liam Burke

Okay, and you mentioned orders getting back to the power plant. You didn't mention countries, different countries but in terms of orders you have in the pipeline now, have you gone beyond Denmark and into other countries in Europe? Or, are you still just in Denmark on the order backlog?

Sune Mathiesen

No. We are looking to expand into Europe and have expanded into Europe and we're kind of working the countries close to home, which makes a lot of sense for us right now. As we expand our presence in the power plant business, we will add further countries further away from home.

Liam Burke

Alright. Thank you, Sune.

Operator

Our next question today is a follow-up from Robert McCarthy of Stephens. Please go ahead.

Robert McCarthy

Yes. Thank you for taking another couple of rounds here. But I guess the question I would have is, obviously you've highlighted some import opportunity. Has that been driven by just maybe a change in how people are thinking about the market in compliance? How do you think about that opportunity? Is there any way to size it in terms of content per port and how you would think about doing that in the context of kind of your thesis around the propensity for closed-loop adoption overall?

Sune Mathiesen

Yes. Thank you very much for that question and it's actually a very exciting opportunity for us. So, by the end of this year we'll have 4,000 open-loop scrubbers either installed or on order, which is obviously

a huge potential market for us for open-loop conversions or to sell them an in-port solution. And what we would be selling is a small filtration system that they can run while in port and it will allow them to run the auxiliary engines while in port and provide power for the ship. So that is a sizeable opportunity. In terms of dollars, we estimate around to \$200,000 to \$250,000 per installation, and you have about 4,000 of them out there potentially, so huge potential.

Robert McCarthy

Great. And then as a follow-up on the power plant opportunity, have you seen in terms of revenue trends even more sequential strength 1Q versus 2Q or anything you can give us about what you've seen in terms of the near-term revenue trends at power?

Sune Mathiesen

Yes. Again, it's early stages. And we're booking orders within our order book, we are pleased with our progress. We've been doing it for a couple of years. We know have a well-functioning product for the power plant market and now we are expanding beyond Denmark. And so it's still not, let's say a big part of our business, but as we move into 2020, we think it will be a meaningful part of our business.

Robert McCarthy

And finally, on NOx, I mean could you just paint the catalyst scenario around that, no pun intended. Will we expect to see IMO coming out with a similar kind of ban there? Would you expect local jurisdictions or local governments to put in effect that ban? How should the regulatory wave kind of occur so that we will be under the balls of our feet waiting for kind of the commercial response to the regulation? How do we think about that?

Sune Mathiesen

We think that NOx reduction is the next big mandate in the marine business. We have seen this mandate for sulfur reduction, [indiscernible] reduction which is IMO 2020. We think there will be a mandate for NOx reduction as well sometime in the future. In the meantime, there are environmental protection zones in place and there you already have to install NOx reduction products. So there is an existing market for NOx reduction in the marine business and we think that in the near future we will see open mandate for that as well.

Robert McCarthy

Thanks for taking my questions.

Operator

And ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back to Sune Mathiesen for any closing remarks.



CONCLUSION

Sune Mathiesen

Thank you very much. And thanks to everyone joining us today on the call. We look forward to speaking with you again on our next conference call that should be in November. And thank you again, and I wish you all a good day.

Operator

And thank you, sir. Today's conference has now concluded. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.