PARTICIPANTS

Corporate Participants

Kristi Cushing – Manager-Investor Relations, Clean Diesel Technologies, Inc.
Robert Craig Breese – President, Chief Executive Officer & Director, Clean Diesel Technologies, Inc.
Nikhil Atul Mehta – Chief Finanical Officer, Clean Diesel Technologies, Inc.

Other Participants

Matt B. Koranda – Analyst, ROTH Capital Partners LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Clean Diesel Technologies, Inc., Second Quarter 2013 Financial Results Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session with instructions to follow. [Operator Instructions]

I would now like to turn the call over to your host for today, Ms. Kristi Cushing, Investor Relations Manager. Ma'am, you may begin.

Kristi Cushing, Manager-Investor Relations

Thank you. Good morning and thanks to everyone for joining us. By now, you should have a copy of our results press release, which crossed the wire this morning prior to market open. A copy of the press release, along with other company information, may be found on the Investor Relations page of our website at www.cdti.com.

Before I turn the call over to Craig Breese, President and Chief Executive Officer of CDTi, I want to emphasize that some of the information you'll hear during our discussion today will consist of forward-looking statements that are predictions, projections, or other statements about future events. These statements are based on current expectations and assumptions that are subject to risks and uncertainties.

Actual results could materially differ because of factors discussed in today's earnings press release and the comments made during this conference call and in the Risk Factors section of our Form 10-K and other reports and filings with the Securities and Exchange Commission. We do not undertake any duty to update any forward-looking statements.

I'd now like to turn the call over to Craig Breese.

Robert Craig Breese, President, Chief Executive Officer & Director

Thank you, Kristi, and good morning to everyone. Our agenda today will follow the same process we've established several quarters ago. I'm going to lead off with a high level overview of our second quarter performance and our progress on our strategic objectives. Nikhil Mehta, CDTi's CFO, will provide a deeper dive on the financial results.

So our positives for the quarter include the following. Firstly, our gross profit margin improved to 25.9%. Secondly, we were successful in our efforts to substantially reduce operating costs, having achieved a 27% reduction year-over-year. And third, we significantly narrowed our net loss from a year ago, which is a very encouraging trend.

And lastly, we've continued to expand – I shouldn't say, lastly really. The next point is we've continued to expand our IP portfolio. We now have filed 26 new patents during the second quarter of this year, 35 patents year-to-date. And of those, 27 relate to what we're referring to as our zero-platinum group metal or ZPGM catalyst technology.

And fifth, we've concluded a strategic review of our business in order to identify ways to accelerate the development of our unique materials science platform. I'll provide more specifics on this later in my remarks.

And I'm very pleased to note that we were honored to announce the appointment of Lon Bell, Ph.D. to our board of directors during the second quarter. Dr. Bell is a highly accomplished executive with significant business, technology and commercialization experience and a deep understanding of the automotive industry. We're also excited about his ability to make valuable contributions, especially given our focus on better leveraging our materials science platform.

So we're pleased with the progress we're making. However, in the area of sales, we clearly fell short of our expectations. Our revenues for the quarter were $12.6 million, a decline of 24.9% year-over-year. Catalyst division sales were down slightly versus last year. However, underlying growth was actually more than 13% after we exclude the impact of reimbursement for rare earth price increases which, as we know, has been volatile over the last few years.

Revenue in our Heavy Duty Diesel Systems division was down approximately 35% this quarter as we experienced lower sales in many of our primary end markets. As confirmed in a report issued by the Manufacturers of Emission Controls Association, known as MECA, just last week, the market in California continues to remain lower than projected. According to the report, the total number of verified diesel particulate filters sold by MECA member companies for in use, on road, heavy duty diesel vehicles in California in the first half of 2013 was exactly 3,508 units.

We believe our share, based on our count, was approximately 17% of this total, which is more or less in line with our historic performance. Under ARB's Truck and Bus regulation, the agency projected that approximately 59,500 diesel particulate filters would need to be installed in 2013 to meet a January 1, 2014 compliance deadline.

The weakness, we believe, if you track first half sales versus what CARB is saying for the second half or the total year, can be attributed to a combination of lack of regulatory enforcement and slower than expected adoption by truck and fleet owners which, as we all know, typically resist putting these expensive systems on their trucks until the very last moment that they can.

Looking to the second half, we'd still believe that market activity will pick up based on stricter enforcement, the approaching deadline for compliance in 2013 and the feedback from our distributors in this market. That's how we triangulate this information. We have done a lot of groundwork to ensure that we're well-positioned to execute in all of our end-markets by continuing to support the sales and marketing teams, adding selective distributors, where appropriate, and making sure we have a complete portfolio of verified competitive product to best serve our customers' requirements.

One of our primary areas of focus this year has been on operational improvement and continuing to reduce our cost base. We made very good progress on these commitments during the second quarter and throughout the first half of 2013. Although our revenues were lower, we are able to reduce total operating expenses by 27% in the second quarter of this year compared to the same period last year. We believe the reduction in operating costs and the streamlining of the organization are sustainable. We are able to achieve this result with compromising our ability to continue to support our growth efforts and continue to invest in our technology – our materials science platform.

Looking at our bottom line performance, while we have more work to do, we're pleased to report a substantial reduction in our net loss both for the quarter and year-to-date. We're doing all that we possibly can in the areas where we can control and improve profitability. We also understand the importance of driving revenue growth. And believe that with an enhanced verified product portfolio, additional sales and marketing capabilities, which we've added, along with the new distributors that I just mentioned, we're now in a position to grow our revenues going forward.

As I mentioned in my introductory remarks, we continued and concluded actually a strategic review of our business. This review yielded two key findings: first, our need to continue to focus and accelerate our technology development, and to ensure that we have an appropriate business structure in place. As a result, we embarked upon an acceleration of our technology roadmap, focusing on expanding our patent portfolio, particularly patents related to our exciting new zero-PGM technology.

Our goal at this activity is twofold. First, we believe first-mover advantage will be critical to some of the commercial development at this technology. And we want to be in a commanding position in zero-PGM products. Secondly, we believe this advantage will allow us to significantly expand our potential catalyst business for gasoline, diesel and natural gas engine markets and potentially applications in other verticals. We're also beginning to see this strategy pay off as noted by our announcement at the end of July that the United States Patent and Trademark Office approved an important patent related to our innovative ZPGM catalyst technology.

So the question is an important one as to, why is low or zero-PGM so important to a global OEM, original equipment manufacturer? It's estimated that approximately $6 billion are spent annually by OEMs on PGM purchases for the manufacture of catalysts worldwide. This is an enormous cost for the auto industry. And it's only becoming more costly with the ever-tightening global emission standards that drive an increase typically in PGM loading per vehicle.

As we continue to advance our technology, we expect to be in a position to offer a compelling opportunity for OEMs to potentially reduce or even eliminate their rising PGM costs. So it's for these reasons and many others that we have made the strengthening of our zero-PGM intellectual property position one of our top priorities in our recently announced strategic business review.

The other priorities are also important and let me just enumerate them: to explore strategic options; to maximize the value of our existing manufacturing businesses; to focus our R&D on technology development, patent protection and commercialization of advanced low and zero-PGM technologies; and finally, to seek customers for our core emission control technology through licensing arrangements, joint development arrangements or agreements and partnerships that would even go beyond a classical coating type relationship which we've enjoyed with a number of OEs over the years as well. This strategy is designed to complement and build on CDTi's core competencies and we're all excited about the progress that we've made to-date.

So now, let's move on to a review of our divisions' business activities for the most recently concluded quarter. Starting with our Catalyst division, we were pleased to achieve a more than 13% increase, after excluding for the impact in reimbursement on rare earth materials, as I mentioned earlier. We also benefited from an improvement in gross margins. And we believe going forward we should be able to sustain this progress.

We're also very pleased to report that this division was moderately profitable on an operating basis for the second consecutive quarter. Our success as a long-standing supplier of catalysts to Honda has been the primary contributor to this growth. We're optimistic that we can achieve improving results going forward with this business, given the success of the new 2013 model year Accord, which according to data published by Honda Motor Company itself, its sales of the Accord have increased by more than 18% as of the end of July 2013 compared to the same period last year, a remarkable improvement.

Our demonstrated track record of success with customers such as Honda has been instrumental in opening doors to other global OEMs to showcase our capabilities. In addition, our joint venture which we announced with Pirelli that commenced in April is actively working and discussing ways to expand business opportunities across Europe with that key business relationship with Pirelli.

Our Heavy Duty Diesel Systems division experienced soft conditions across most of our end markets, both in the U.S. and in Europe. Government funded programs across the United States have been slow to announce new initiatives in spite of the MECA data, indicating a slowdown in the second quarter. We're seeing some signs of increased activity in both funded and mandated retrofit activity in the California market and that includes both, the truck and bus initiative as well as the school bus.

Expanding our Heavy Duty Diesel Systems division sales from non-retrofit sources remains an important area of focus for us as they represent a more sustainable OEM and aftermarket business for the reduction of exhaust emissions. For the second quarter, non-retrofit sales represented fully 48% of our Heavy Duty Diesel sales compared to 36% in the second quarter of 2012. And I should mention that the non-retrofit sales also include an analysis of our Reno exhaust business sales as well who sells some to retrofit and some to OE businesses, a small but very important part of our overall business portfolio.

Moving to our balance sheet, after the completion of the second quarter, we strengthened our balance sheet with the closing of a public offering and a private placement in early July, which resulted in net proceeds to CDTi of approximately $1.8 million. Our intention is to use these net proceeds from the offering and placement for general corporate purposes.

So, in conclusion, our focus and priorities remain clear: drive additional revenue growth, develop our innovative materials science technology, and continue to control costs and expenses, wherever possible.

So now, I'll turn the call over to Nikhil for his comments on our financial results and operations.

Nikhil Atul Mehta, Chief Financial Officer

Thank you, Craig, and good morning, everyone. Following Craig's operations overview of the second quarter and business outlook, let me discuss in greater detail our financial results.

Revenue of $12.6 million was down 24.9% compared to last year. Gross margin was 25.9% compared to 25% in the prior year period, up 900 basis points. Gross margin also improved sequentially from the first quarter of 2013 and was within our expectations. We anticipate that gross margins will gradually improve as sales volumes increase. Loss from operations was $1.2 million compared to a loss of $1.9 million last year. Loss per diluted share was $0.19 versus a loss of $0.31 last year.

The highlights from our business divisions include the following. Our underlying Catalyst division OEM sales were up over 13%, as Craig has mentioned, as Honda Accord sales continue to be robust. Reported sales were down just around 2% due to lower prices for rare earth elements. Included in this quarter, the revenue is approximately $150,000 of reimbursement for rare earth prices compared to over $1 million last year.

As we have explained previously, this reimbursement is received on a dollar-per-dollar basis and as such has no margin. Gross margin was up from 11% in 2012 to over 17% this year due to the reduction in the rare earth pricing as discussed as well as continued improvement in manufacturing efficiencies, somewhat offset by a reduction in year-over-year intercompany sales which are usually at higher margins.

Heavy Duty Diesel Systems division sales of $7.1 million were down over 35% from $11 million a year ago. Sales increased approximately 12% in California and approximately 19% in our North American OEM businesses. However, sales were down in North American retrofit activities in the other 49 states. In addition, in 2012, we had significant sales in New Jersey Retrofit Program and the Texas School Bus Retrofit Project last year.

Sales were down in our mining and material handling business in Europe and also in our exhaust and accessories business. Lastly, in the second quarter of 2012, we had approximately $1 million of sales in Low Emission Zone which did not repeat this year. We recorded approximately $2.8 million of sales under the California Retrofit Program.

Gross margin in this division declined approximately 1 percentage point year-over-year to 29.8%. Margins actually improved as a result of richer product mix sold in California and North America compared to what we did last year, as well as due to a higher content of CDTi manufactured low precious metal catalysts. This improvement was offset by reduced margins in Europe due to commissions on sales made through our joint venture and also due to lower sales volume.

Operating expenses were down $1.6 million or 27% from the $6.1 million a year ago to $4.5 million. Reductions resulted from several restructuring actions implemented in the second half of 2012, partially offset by increased spending on our patent filings.

We had $3.2 million of cash at the end of the second quarter and cash usage for the quarter was $1.4 million. As previously announced, on July 3, we completed a public offering as well as a private placement which collectively netted approximately $1.8 million in cash.

That concludes my prepared remarks on our financial results and operations. Back to you, Craig.

Robert Craig Breese, President, Chief Executive Officer & Director

Thanks, Nikhil. And just in conclusion, I think it's clear that we continue to push forward in a very aggressive manner to expand and deepen our technology platform, our patent portfolio and all of the activities that are really hovering around our – what we believe is very critical technology efforts for the future. At the same time, our businesses are in different places. We have a catalyst business, primarily with Honda, that's right now performing very well.

Not only our volume is up but what we've seen are major improvements in the operating into that business, including scrap reduction, better productivity in terms of man-hour, a whole lot of metrics that are behind the story that don't necessarily come out in the financials directly. But I can assure you that there's a lot of people working very hard to improve these results. And we don't' take it for granted.

At the same time, in our heavy duty diesel systems business, we remain challenged in the revenue column, as we discussed. But I can tell you that we have added sales resources in the first half of this year. As those sales resources start to kick in and start to develop new prospects and new opportunities in the business, I remain confident that that will ultimately translate into increased revenue, not just in the retrofit end of our business, but in the critical original equipment and aftermarket segments as well.

And as we've said previously, our continuing discussions and relationship with Pirelli, the story isn't by any means finished with Pirelli. It's just at the beginning stages. But we continue to remain very encouraged by the early steps that we're taking to form a closer partnership and relationship with that key strategic partner.

So, at this stage, what I'd like to do is, operator, open it up for any questions that there may be from those that have dialed in.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Philip Shen of ROTH Capital Partners. Your line is open. Please go ahead.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Good morning, Craig and Nikhil. This is Matt on for Phil. Thanks for taking my questions. I just wanted to start with --

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Hi, Matt.

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Good morning, Matt.

<Q – Matt Koranda – ROTH Capital Partners LLC>: I just want to get started with sort of the overall strategy in the materials science platform you guys have been talking about. Maybe you could give us an update on the licensing strategy and perhaps some of the – maybe some color on the reception that you're getting from OEMs on this strategy versus the prior manufacturing-based strategy that you had?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Right. And, again, Matt, I'm happy to do that. For competitive reasons, I'm not going to mention specific potential or existing partners that we've reached out to and had discussions with. But I will tell you that we have had discussions now with a number of original equipment manufacturers, not just in the automotive sector or segment, but also in other segments. And it's been very encouraging, actually.

I think there was a recent article that Mitsui Corporation just issued a day or two ago, I found it very interesting that they issued the article, because it basically is a defensive article around the concern, I think, that they now have as a corporation that there's somebody in the field with a zero-PGM development that could challenge basically their core business in coating with PGMs. And, of course, it's not just Mitsui. It's the whole group of major competitors that we face in the industry.

We're really – like we did a number of years ago, when we entered into the foray, we're upsetting their applecart. We're a disruptive technology company. And as those discussions continue and we start to craft actual business agreements or licensing agreements or technology agreements around them, the idea is how can we offer or bring to them value which translates into value for their customer set and also translates into value for CDTi shareholders. And that's the key point here. So, while I don't have any blockbuster announcements to give you this morning, what I can tell you it's steady. It's almost like a drip irrigation where we're applying it one drip at a time. We have a very sequential and methodical approach to this. And the reception has been very positive.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Great, great. That's great color and definitely understandable that you can't mention specific OEs. Along the lines of the commercialization strategy that you had mentioned, given all the patents that you guys have filed, maybe could you share with us, sort of, how you're approaching the commercialization of these technologies? Maybe you could just share a little bit of color around sort of timing and how it might vary between the various applications?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Right. I mean what I think we have shared in past documents is a roadmap in terms of segments that could potentially be using this technology. Now, keep in mind, this is a contiguum, Matt. It's not one day we flip a switch and we go from conventional technology to no PGMs at all. It's more of a contiguum. So you've been – and the industry has been working to reduce precious group metals for many years, us included obviously. So that march continues. And the march ends up where there is no precious metal in a given application. But keep in mind that three-way or two-way catalysts are complex and not one size will fit every single application on the globe.

So there will be some cases where we're going to need to provide some PGM in some aspects – in the case of an application when we have what we call two bricks, maybe one brick is coated with some PGM, maybe one isn't. And then eventually neither one is, okay. So it's very much about what the end-use application is and how it needs to be calibrated to meet emission standards, at the same time driving down cost, wherever possible, right.

And so what's encouraging to me is probably for the first time in our history, we've been reaching out beyond just the automakers into other applications in the two-wheel vehicle markets such as motorcycles and in specialty equipment, let's call them all-terrain vehicles, for example, here in the United States. These are markets which consume a lot of catalysts which are not easy applications, but in a lot of cases, aren't as regulated as automotive applications are. And because they're niche and they're smaller, some of the bigger guys tend not to spend as much time engineering or developing in these areas only because they have such a huge market in the automotive end. And so I think what we're discovering over time is there's lots of different places that our technology that we have already today can play, but that with this roadmap that we're developing can play in the future as well.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Great. That's also helpful. And I wanted just to switch gears to HDD here, specifically in the California market. Maybe if you could just comment on sort of the latest enforcement efforts by CARB. What are you seeing there? And do you see any quantifiable benefits to maybe interfacing with CARB on a regular basis?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes. Well, okay, there's two parts to your question. Let me take the last part first. So about a year ago, we started a concerted effort actually through a consultancy in Washington, D.C. to help us get in front of the right people in CARB. Traditionally, CDTi or the heavy duty diesel business had not really forged, what I'll call, high-level relationships with the CARB organization. We had relationships at the working levels, at the people that did verifications, but not so much at the policymaker end or at the end where they were really drafting a lot of the regs and working with other entities within not just the state of California but also EPA to bring these regulations to market, if you will, in California.

So I think a year later, I can safely say that we have very good relationships at pretty high levels now in the CARB organization. And those relationships have, frankly, eased our working relationship a lot with the organization. It's more fluid. It's more interactive. It's, I'd say, just much easier and even a pleasure, in many cases now, in dealing with that organization. At the same time, unfortunately, we don't set policy and, to some degree, CARB doesn't either, in the sense that they don't have their own ability to influence their budget. And a lot of the constraints that CARB has is around money and they only have limited resources to expend on enforcement, unfortunately. And I think as a result that limited ability to do more aggressive enforcement, which they clearly want to do, has really – it's hindered them and it's hindered the industry.

My belief, I still remain steadfast in believing that these penalties are real. They're not going away. They are being imposed in many cases on a case-by-case basis already. And by the end of the year, I would expect that there will be a number of fleets and truck owners that are going to be knocking at our distributors' doors and our competitors' distributors' doors, saying hey, can you get me a retrofit quickly? I need it. I don't want to be out of compliance. I understand I'm going to get penalized. We had seen this in other retrofit scenarios before. It's certainly, unfortunately, part of the business model. And I still expect to see a surge here in the second half of 2013. I cannot quantify what that surge looks like. Do I believe the CARB numbers that it's 59,500 units? Probably not. But I also don't believe that it's anywhere as near what the run rate in the first half was either.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Great. That's really helpful color, Craig. Just one more, if I may here. You mentioned that you guys have added sales resources to deal specifically with the California market and perhaps expanding into some of the other lower 48 here. How do you expect this to affect OpEx going forward in 2013, 2014? You guys have made some great progress bringing down OpEx. Can you comment on how that might trend?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes. It's a good question. I mean – and the way I look at a sales resource, there's short-term, medium term, long-term sales opportunities. The company right now has enough short-term, and I'll term short-term three months, not just in California but in other parts of the market that it's a fairly easy calculation honestly, Matt, I mean, for what a sales person all-in costs versus, we call it, a productivity analysis, what are they producing in the way of additional revenue and profit. The payback analysis is actually quite attractive to adding these folks.

Now, in a longer term or medium term, okay, where the sales cycle takes longer to develop and the revenue doesn't come as quickly, clearly that's the area where you become more challenged. But right now, the additional resources that we've added in are primarily focused on driving short-term, near-term revenue. Hence, while we do have some operating cost increase, I believe that it's more than adequately provided for in the additional revenue and profit that it generates. And if it doesn't, I mean we're keeping a very close eye on that. We may have to do some realignment down the road, but I just don't see signs of that at this time.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Great. Also helpful and thank you, Craig. That's it for me.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Thanks, Matt. Operator, are there – yeah.

Operator: Thank you. Our next question comes from the line of Thomas Cochran of Lakewood Partners. Your line is open. Please go ahead.

<Q>: Thanks. A little further on CARB, it sounds to me as though they want to enforce the rules but don't have the money. Is that correct?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: It's certainly one of the aspects, Thomas that we've been confronted with, yes.

<Q>: Okay, fine. The pollution from diesels is something that's a great concern to all kinds of environmentalists out in California. What if you persuade one of those environmental organizations to put up the money for CARB to enforce its own rules?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: I mean that's a really creative idea. Here's kind of the reality. I mean it's a great idea. We're in a tough spot as a manufacturer, candidly. We are trying to be helpful to the regulatory industry which is, in this example, CARB.

<Q>: Right.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: But we're also not trying to pick a fight with the trucking industry.

<Q>: Oh, yeah. If I can interrupt, I had no thought that you would be identified with this move at all.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Right.

<Q>: But if some other stockholder or somebody quietly from within the company goes to the Sierra Club and says hey, listen, why don't you guys put up some money for CARB to enforce these rules that are causing – the lack of which is causing so much pollution.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes. I mean I would be --

<Q>: No. [ph] You should be absorbed, correct (32:24)?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: I think it's a great concept and I'll tell you what. I mean I would happy to provide any contacts within the CARB organization for anyone that might like to pursue that idea.

<Q>: All right. I'll give you a call later. And the first thing is whether legally an outside organization can fund a state organization. I don't know the answer, but thanks.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: I don't know, but as a private being, I'm funding the California organization through my taxes.

<Q>: Yes.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: So, anyway, I appreciate it, Thomas. I look forward to your call.

<Q>: Okay. Thanks, Craig. Bye.

Operator: Thank you. Our next question comes from Karthik Srinivasan. Your line is open. Please go ahead.

<Q>: I have some questions for Craig. I guess my first question – I'll just ask a question and let you respond. You talked about your share for CARB retrofits in the first half of 2013 being essentially flat from where it was I guess last year at 17%. I'm just curious, why is that share not extending given Cleaire's exit?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Good morning, Karthik. How are you? What I would say --

<Q>: Doing fine.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: What I would say to you on that, it's a good question. A couple things transpired in the first half that I think have distorted these numbers a little bit. One of the competitors does not report into this MECA association. That company's name is Hug. And that company's sales are not 100% known. In other words, they're not reporting. And so, I will tell you that these numbers are, I think, relatively accurate, directionally accurate, but they may not be perfect for that reason, all right. That's just a caveat.

Now, as far as the Cleaire absorption by ESW, all right, because the market was so slow in the first half of the year, there was very little movement. There were a number of systems that were in process of being sold which ended up being sold despite the bankruptcy, all right. So, it isn't like nothing was happening, even though they went bankrupt and ESW then bought their assets and then now continues on.

So, I think that's an important piece to this. At the time that Cleaire went out, nobody really knew how that story was going to end. The way it's appearing at its ending is that ESW bought its assets, including its verifications, and is now up and running, trying to sell what were formerly Cleaire solutions, if you will, and is in the market actively selling, not just ESW product but also Cleaire product. So, I would say that because of the low numbers, what was in process as well as the Hug factor, we haven't seen the kind of bump that we would have expected from that bankruptcy. I agree with you on that.

<Q>: Okay. My next question pertains to the press release that you put out regarding the materials science platform. You actually referred to this again today in your earnings release. But one of the strategic priorities that was listed was to explore strategic options to maximize the value of your existing manufacturing assets. Can you explain exactly what that means? It's really unclear. Do you intend to divest those assets? Are you just trying to build up the business there? And if so, I mean what's in the business development pipeline? Because I really feel like this company is being managed on hope rather than reality and we keep hearing about new business opportunities but it just keeps getting pushed out further and further.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Well, I think when one says pursuing strategic options, one is not limiting themselves to any one option. Clearly, the examples you cited such as divestiture are an option. I've touched on the Pirelli discussions. That's an option. And there's other areas of discussion that are ongoing and are being reviewed by the management right now. Clearly, I don't want – and this is a public forum that we're on. I don't want to be divulging anything more specific than that because I'm trying not to get my competitors a leg up on what I'm trying to do at the same time.

So what I can tell you is in terms of the manufacturing organization, we understand that revenue has been disappointing in the heavy duty diesel side of the business and we have to figure that out. Either we drive more revenue or we find a way to manage the cost structure differently or we do something different than what we're doing today because I'm convinced that if we continue doing what we're doing today, we may end up getting similar results. So none of us want the same results that we've had in the past several quarters and I'm sure you, as a shareholder, don't. But at the same time, in order to get better results than that, one has to explore different options. And that's what we're doing.

<Q>: Okay. My next question pertains to Honda. So Honda put out a press release, I believe, it was last September 2012 which extensively touted your technology in terms of its ability to deliver similar performance to PGM based catalysts and yours is obviously a low PGM and we're heading towards zero-PGM. And I appreciate you're able to add additional lines with respect to the Accord but the expansion of the Honda business just really hasn't materialized. Can you give us some understanding exactly what's going on there?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Well, again, as you know, Honda, like most OEs, has about a five-year roadmap on new models that they're developing for launch. And we were fortunate enough to win the model year 2013 award but that work actually started back in the timeframe of about 2009. And so we have ongoing discussions and reviews with Honda. We are actually in active discussions with them about new models that they will be bringing to market in the next several years.

But at this point in time, those are developments. Those are discussions. But those aren't awards and they won't be awards really until they've finished their own technical review and come to a decision where they want to put the business. But we're very active in that regard with Honda and we have a number of projects or programs that we're discussing with them simultaneously.

<Q>: All right. My last question for now, and I'll go back into the queue after this, really pertains to the cost side of the business. And while I appreciate you've done a good job – and you and the management team, I mean. I didn't mean to exclude anyone else who's involved in this. But there's been a good job in terms of managing costs in the face of revenues that just really have materialized.

But I'm a little puzzled as to the reduction in R&D and I understand there were a couple one-time factors in Q2 2012 that didn't anniversary. But given the value of this business is really in the IP side but, to be honest, I'm a little puzzled as to why the R&D was taken down so low relative to SG&A where we've been increasing sales but we just haven't seen any business development. So it just seems a little odd what's the interplay between those two line items?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes. It's a good question. It's how we categorize R&D, Karthik. So in our vernacular, we're including verification cost in R&D. So what happened in 2013? We had a very high rate of verification in 2012, very high rate of verification cost both in the number of verifications, for example, our EGR system and then some subsequent verification that came on top of that that CARB required of us, as well as some other programs.

And the numbers in terms of doing that as well as the Honda model year development, which are also kind of stacked in front of a new model year arrival, I would say kind of skewed those R&D cost in 2012. Those aren't necessarily repeatable year-after-year but sometimes they will come in bunches. And that's definitely what happened last year. So I don't think we should get as much credit, frankly, for reducing R&D year-over-year. We should be look at it more from the standpoint of year-over-year what's required to run the business and what's required to develop or invest in the business.

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Yes, Craig, I would just – Karthik, just to kind of build on what Craig just said. We had two – actually if you go back, we had two years, 2011 and 2012, where we had the significant amount of activity in verifications. And the point that Craig made on the Honda pre-launch, when we do the pre-launch work for Honda, a lot of it is categorized as R&D. And there's a fair amount of what we call pre-manufacturing stuff and that happened last year, too.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes.

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Okay. So --

<A – Craig Breese – Clean Diesel Technologies, Inc.>: What here – if you strip that away and just look at the actual development, I mean by filing these patents and by adding some of the key resources in the R&D group itself, what I can assure you is the activity level right now on new technology development, I think, is as high as it's been in many, many years in this organization. And we will continue – as we say in our remarks earlier, we'll continue to focus and ramp that up because we believe it's real and it's going to pay off for our shareholders and our customers.

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: And --

<Q>: So just to follow-up on this then. So is the – Q2 2013 R&D level, is that the run rate level we should think about for your business in the absence of product verification and product prototyping costs you may incur for new customers?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: There is some verification still going on at a much lower level, much less expensive than a year ago. I will tell you that if we got into a serious, how shall I say, campaign within, let's say, a new OE or even Honda, there would be, as Nikhil just pointed out, some additional upfront costs. Now, if we don't know about that campaign today, I can't really tell you what it is. But assuming that it was real and that we identified it, yes, we would reflect that definitely in our investments and in our numbers. Because I mean --

<Q>: Okay. I'll go back in the queue.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes, okay. Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Gary Cooper of Pace Capital. Your line is open. Please go ahead.

<Q>: Hey, guys. I've got a couple questions but I want to make a statement first, so that we all understand this. You did an equity deal. You gave away 33% of the company. And you generated roughly $1.8 million of cash. You'll get some more cash on the warrants. But at your current cash flow burn rate, that's only worth one-quarter of cash flow. So, to me, that doesn't make any sense. And my bigger point is you can't do it again because the amount of dilution on the next deal will be even greater. What I would do is I'd put the company up for sale or I would prepare to do that. You can't do another deal. That's my point. Did you guys hear me?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes. No, we're listening, Gary.

<Q>: Okay. So my question – one of my questions is on the non-CARB stuff, let's call it, Jersey, Texas and so forth, what is out there? What's available in that area that might be potentially new business in the future?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes. I mean so there's actually a bit. The funding mechanisms within the 49 states have changed quite a bit in the last few years. And it's kind of moved from, what we'll call, the DERA model which was the model that had been followed for a number of years to more, what we'll call, the CMAQ model which is, let's say, more localized. Okay. So it's more driven by the states themselves or the non-attainment zones and the requirements that they need to retrofit in many cases, state vehicles or vehicles within the non-attainment zone.

What we've been able to do is gather quite a bit of information internally through our regulatory folks and in discussions with EPA in Washington specifically and really started to target specific opportunities around the 49 states. And I don't – again, because this is public, I probably don't want to say too much about the specific ones that we're seeing or targeting. But I can tell you that there's approximately 13 of them. And they're in different geographies across the 49 states. You mentioned a few that had been relatively active and robust in the last couple of years. As those are winding down though, there are a number of opportunities that we're working on right now. And some of them are fully funded. And some of them, frankly, we've written the specs on. And so, I'm in a position where I believe we're going to pull some of that business in yet this year. And some of it will spill into 2014, the ones that we have in our line of sight today.

Now having said that, there will always be – this is on an annual basis. There'll always be new programs and there'll always be new funding set aside on a going forward basis. And so this is an evergreen process. It's not one and done and it's no more ever again. But right now, I'm encouraged coming out of the recession – as they've kind of restructured the way the funding works, I'm encouraged to see a number of states stepping up and saying, hey, we want to get this done. We've got the money. We want to go. And that's where our sales team – when I said earlier in the remarks near-term opportunities that's what I was really referring to. Near-term opportunities where we're going to spend a lot of focus and time and technical sales resource on trying to drive that business to happening for us, okay. That's exclusive of what we're obviously talking about here in California.

<Q>: Yes, okay. So on the CARB side, right, last quarter, you had given us an update sort of behind the idea that Cleaire had had its troubles and you had given us an update on a couple of new distributors that you have signed. Can you give us an update on where that business is? Can you tell us whether the account receivable line, which is not down as much it was in the prior year, is related to that? And also whether you've signed any more or any additional distributors in California?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Since our last update on this subject, I would say this. We have not signed any new distributors. But what I can tell you is the status on those new distributors that we did sign early in the year. I mean their track record is phenomenal. I mean, they've done a really good job of driving new business that we didn't have a line of sight on and our other distributors didn't have a line of sight on. So I think that is truly business we wouldn't have had, had we not signed up those distributors. And in a couple of cases, those are stocking distributors, which is great for us and great for them.

Now there's, what I'll call, the reactivated distributors. So there's some distributors out there that had pulled away from us for a variety of reasons, either we didn't have an EGR product or could be just other reasons, could be relationships with their sales rep, what have you. So as we've kind of reinforced our structure and our focus on this business, we've actually reactivated a number of, what I'll call, sleeping or less active distributors and that's been encouraging. I've started seeing orders coming from distributors that we haven't seen come from orders from these guys for several years actually, Gary. So, I mean, that's an effort of the sales effort in the market and a function of having a more complete range of products to offer them, I would say.

So that's good news. But at the same time, as you see from the overall numbers, that's just kind of keeping us where we are. That's not necessarily breaking through the ceiling yet. But I do believe that that helps position us as what I'd still think as a surge here in the second half of the year. And, by the way, it's not me saying that, it's me discussing it with virtually every distributor I talk to, that – I think that's going to stand us in good stead as we get further into the year here.

<Q>: Yes. Well, let's explore that for a moment then, right. So I think I've asked this question twice over the last 18 months and I asked it about this time last year. Let's – we know – everyone knows that the CARB thing is disappointing and it's not going to come home the way it was once envisioned. But --

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Right.

<Q>: In the event that there is some sort of surge of demand, what plans do you, as a company, have in place to manage your working capital? Because inventory is going to be going out the door, it's going to be going out the door fast, and you're not going to be receiving cash for it. And I think given the recent equity deal and my feelings about that, I really want to know what the plan here is to manage this.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: So, there's a couple key points to this. In anticipation of this surge, which never really materialized the last two years, we've leaned out our supply chain dramatically from where it was two years ago. I mean I think that our operations team in both California and Canada has done a tremendous job of really getting good at turning product around quickly inside of a timeframe that really preserves working capital, okay. So that'd be the first thing I want to say to you, all right.

The second thing is we do have forecasts, okay. But we also work with our supply base, wherever possible, to put some of the burden on them. And what that means is extended terms. What that might mean would be consignment in certain cases or other clever ways of managing working capital where it's not on our books. And, again, here due to the competitive aspects of this, I don't want to share specifics around that.

But I think our supply chain guys have done a tremendous job negotiating with our supply base to get us in a position of not just rapid response time, but also preserving our cash and making sure that our cash is turning in a very efficient manner. And that's basically what we see and how we've been managing it. So, even with the surge, I'm not seeing a particularly onerous situation at this time, based on even very optimistic forecast in this regard. So that's what I would tell you now.

<Q>: Okay. That's fair. I'll jump back in the queue. I'm going to conclude with a statement though. I've read your 10-Q and I see that it says you've got enough cash to get through the end of this year and maybe into 2014. But – and who knows what the cash flow burn rate will be, but that's probably a pretty accurate statement. So, in the absence of something materially positive in the operations of the business, you have got to be prepared to put this company up for sale and sell it because you have a window and you are on the clock. You've only got enough cash to maybe get to this point next year and you have to be prepared rather than diluting shareholders again. I'll sign off.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Gary, we certainly understand your message. We appreciate your comments. And we continue to act in the best interest of our shareholders, our employees and our customers.

Operator: Thank you. And I'm showing no additional questioners in queue. I'd like to turn the conference back over to Mr. Craig Breese for any closing remarks.

Robert Craig Breese, President, Chief Executive Officer & Director

Very good. I think the numbers and the commentary speak for themselves. We will really just re-dedicate ourselves to the key points we made earlier in the conversation. We'll continue to aggressively develop this new technology. We'll continue to drive revenue any way we can, in spite of a lot of headwinds. But at the end of the day, we've got to manage those headwinds as best we can and overcome them, wherever possible. And we'll continue to manage our cash and our operating expenses as diligently and as capable as we possibly can.

So, again, I appreciate everyone's interest in CDTi. I appreciate all of the employees' efforts around the organization to contribute to our progress and our success. And we look forward to the next earning scall. Thank you.

Operator: Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program and you may all disconnect. Have a great rest of the day.