

ZOLTEK

Moderator: Zsolt Rummy
February 16, 2005
10:00 a.m. CT

Operator: Good day everyone and welcome to today's Zoltek first quarter 2005 earnings results conference call. As a reminder, today's call is being recorded.

And now for opening remarks and introductions, I would like to turn the call over to Mr. Zsolt Rummy, President and Chief Executive Officer for Zoltek. Please go ahead, sir.

Zsolt Rummy: Thank you. Good morning everybody and welcome to our conference call. Before we get into some of our details, I want to make a note that several people were concerned about the timing of our call being about a week or so after our earnings release.

Just to let you know how we feel about it, we have had very little attendance and although there are some interested people, we usually get about 20 people on these conference calls. It is part of our investor relations program, so we didn't have any high priorities, so to speak, for the timing. But given that there was enough concern expressed, in the future we will make it closer to the press release, hopefully maybe within 24 hours or 48 hours after the release is out, to avoid any speculation of rationale or reason why we don't schedule it sooner.

Having said that, the first thing we need to do, again for legal purposes, is to read you the disclaimer and Kevin has been doing a good job of this.

By the way, Kevin Schott, our CFO is with me in the room so I will turn it over to him to read you the boilerplate.

Kevin Schott: Thanks, Zsolt. As Zsolt mentioned, we need to put out our legal disclaimer.

This conference call contains forward-looking statements which are based upon current expectations of the Company. Because these forward-looking statements are inherently subject to risk and uncertainties, there are a number of factors that could cause the Company's plans, actions and actual results to differ materially. Among these factors are the Company's ability to reactivate its formerly idle manufacturing facilities on a timely and cost-effective basis to meet current order levels for carbon fiber successfully; add new capacity for the production of carbon fiber and precursor raw material; execute plans to exit the specialty businesses and reduce cost; manage changes in customer's forecast requirements for the Company's product; continue investing in applications and marketing development; manufacturing low-cost carbon fibers and profitably marketing them; timing and occurrence or nonoccurrence of transaction events that determine the future effects of these factors on the Company, as well as other factors that may be beyond the control of the Company. The Company undertakes no obligations to update any forward-looking statements to reflect events or circumstances after the date of this conference call.

Zsolt Romy: Very well done, Kevin. In reviewing the highlights for the quarter, our last conference call really wasn't that long ago since it was the year-end and our financial 10-K is due 75 days after the quarter's closing, so that's near the time when we had our last conference call.

Nothing extraordinary has happened since that time other than the fact that sales continue and are not a problem. It's more about supplying against our contracts and how to deal with the expansion of sales and future sales, how to control it and how to maintain our position in the market to continue leading the market, and also to make sure that we don't discourage anyone from continuing their carbon fiber projects, so that we can make sure that this sales expansion continues beyond 2007 and into the long-term.

This also continues our efforts to concentrate on operations to make sure that we can produce against these contracts, as well as produce at a profit, which of course includes a lot of activities in recruiting good personnel and also to improve our operating reliability and continuing cost reduction projects.

The other thing that is significant as of the last time discussed – we were looking to finance our second phase of our expansion program which is two million plus pounds of carbon fiber, four million pounds of precursor capacity expansion and improvement projects to improve our carbon fiber line production by as much as 20 percent.

With this background, I'll turn over the call to Kevin and have him go through the highlights of the financials. Not to go into detail, but to reiterate the important points, and then we'll have time to answer questions if you are interested in any more detail.

Kevin ...

Kevin Schott: Thanks, Zsolt. Again, I'm not going to spend a whole lot of time regurgitating numbers from the 10Q. I just want to hit a couple of highlights regarding the first quarter of 2005.

Just to make everyone aware, our presentation still includes our discontinued operations presentation of our Crumeron and Danamid filament divisions in Hungary, so the 2004 numbers have been changed to reflect that discontinued operation treatment of those two divisions. The 2004 numbers do look significantly different compared to what you saw in the 10Q for 2004.

Regarding discontinued operations in 2005, we did continue to sell some existing inventory that was on the books as of September 2004 for this first quarter. Going forward for the second and third quarters you will see a very small impact related to our discontinued operations in the 2005

quarters because basically most of that inventory has been sold off and we are obviously no longer producing any inventory related to those products.

Just an overall picture related to our first quarter of 2005 — sales obviously were up, operating profit was up compared to the first quarter of last year, and obviously net income was up as increased sales have improved all of those operating line items.

Regarding sales, we were up \$5.3 million from the prior quarter of fiscal 2004, that's a 66% increase. Most of that was obviously made in our carbon fiber division where we had a \$4.5 million increase over the first quarter of last year. All that again relates to our wind energy business contracts along with our Asian sporting goods contracts, where we had significant sales in the first quarter of this year.

Our technical fiber business was also up by about \$500,000 this quarter compared to the last quarter of fiscal 2004. Again, our major customer related to that business has increased its output and we are continuing to supply them.

Over a sequential quarter related to the fourth quarter of 2004, we were up about 10%, \$1.2 million of that \$1.6 million was related to the increased sales in our carbon fiber business, which was again about a 32% increase over the fourth quarter of 2004.

The decrease was basically a slippage of about \$0.4 million in our specialty business products area. We still have two business lines open over there – and it was basically just a seasonality factor related to the netlon and our CMC business.

The increase in our sales basically created an increase in our operating profit of \$1 million over the first quarter of 2004, which is about a 38% improvement, as 20% of all sales dropped to our

operating profit line as the production and sales of our carbon fiber products. We started to absorb the available unused capacity cost which dropped about \$900,000 from the first quarter of 2004.

One thing I really would like to talk about is our gross margin. The percent of our gross margin was only about 8% this quarter compared to 14% in the prior quarter. This was basically caused as we opened our Abilene facility — we started absorbing the available unused capacity cost into our cost of sales.

The production at our Abilene facility, along with the production of our precursor operation in Hungary didn't operate to the efficiency we would like to have seen them operate in the first quarter which means we did not absorb all the fixed manufacturing costs. That has improved significantly in this quarter and we continue to see improvements everyday in that area, so our gross margin percentage should improve going forward in future quarters of 2005.

The financing costs really relate to two things. As I've mentioned in prior calls, one is we have an amortization of warrant discount which is a non-cash charge of about \$900,000 per quarter compared to basically zero in the first quarter of fiscal 2004. This amount will continue on the books, as we have the convertible debt. It could fluctuate quarter to quarter as some of the convertible debt is being converted, but once the convertible debt is gone, that number will be zero.

The interest costs were up about \$500,000. Again, that's just related to the new debt issuances we have done to either refinance current debt or build cash to be able to operate the business plan and to do expansion.

Net income from continuous operations was only up about \$100,000 over the first quarter of 2004. Again, the operating profit was up over \$1 million. That was offset by financing costs of roughly \$900,000 which mainly relates to the amortization of the warrant discount which is a non-cash charge and will eventually go away as the convertible debt is converted and extinguished.

As a company, we are focusing on increasing that operating income line item. We know that as the operating income line item increases, the financing side of things will take care of itself in the long-term picture of where this company is going.

Real quickly we'll jump to a couple of points that are cash flow related and we'll focus on our convertible debt first. As Zsolt mentioned, in February a couple of weeks ago, we closed a new round of convertible financing. It was a \$20 million convertible deal at 7.5% interest. The term is 42 months. The convertibility of that \$20 million is at significant premium to what our current market price is. It has about 450,000 warrants attached to it at an exercise price of \$17.50, again at a premium to what our current market price is.

This will be used for two purposes. The first purpose will be to pay down some existing mortgage debt that we had, \$6 million which was at 13.5% percent interest, which we did basically a year ago to refinance the U.S. properties. We are going to pay that off as part of the proceeds. The second piece of the proceeds will obviously be used to do the expansion of our precursor lines, along with building the two new carbon fiber lines in Hungary. So this gets us to a point where we'll end up having nine carbon fiber lines and the ability for our precursor lines to supply the raw materials for nine million pounds of product.

Basically, the capital or the debt structure of the Company will be in the range of about \$12.3 million of term loans and revolver loans, and we will have approximately \$50.7 million of convertible debt after this \$20 million loan is done. That \$50.7 million worth of convertible debt will convert into about 5.6 million shares of which there are some warrants attached to that. As part of this convertible debt deal, we had about \$10 million of convertible debt that has converted from the deals that were made in January 2004 and in March 2004.

So we've increased the overall debt of the company by \$4 million, but actual cash interest payments will actually be decreased because of the factor of the interest rates of what we were dealing with there.

The capital expenditures for the quarter were basically \$2.5 million, as the Company continued to spend on increasing the precursor capacity, along with starting the process of adding the two new lines in Hungary.

This will continue at this rate or probably actually increase during the time that we are actually doing the installations of the two new lines in Hungary for this fiscal year 2005.

The last piece I want to talk about is the inventory. We did have a fairly significant increase in our inventory balances. That related to mainly three areas. First of all, there was a significant foreign currency change related to our Hungarian inventory. The forint strengthened basically 20-cents on the dollar between September 2004 and December 2004, so that was obviously a significant increase in the value of our Hungarian inventory.

Second of all, we are building up our raw material capacity to be able to produce the carbon fiber.

And third is the seasonality factor related to our Pyron products that we continued to produce over the holidays in December where our major customer actually shuts down production. And so we did build up some inventory balances related to our Pyron products that will reverse-out in the quarter ending March 31, 2005.

After Zsolt gets done, I'll be more than happy to take calls. Any questions that anybody will need answered. But I'll turn it back over to Zsolt right now.

Zsolt Rummy: Thanks, Kevin. Let me go through our sales efforts. Again, as I mentioned in the introductory comments, we have more sales than we know what to do with, but we do have to deal with it and so our objective for sales is to have 60-70% of our capacity committed on contracts, and then 30-40% used for responses to immediate needs as well as to increase our value-added revenue base.

So that's our target right now to align our sales contracts to 2007, which again at this point based on our plans, we're pretty well sold out through 2007, including our planned capacity expansions.

That's good news and of course there's a concern about how we will deal with the future expansion and the scale-up of our business. We are looking to concentrate on future markets that are important to the commercialization of carbon fibers. We still feel that the long-term strategy of the Company is good and in order to maintain the growth -- and again, not just an incremental growth, but a sizeable scale-up of the Company.

We need to make sure that we keep the future projects on track, and one of the problems of course is, that the reduced availability and perceived higher pricing has already resulted in some people canceling some active projects going forward. So this is something that we're watching very carefully and try to maintain our contact in the industry and to assure the industry that this shortage in carbon fiber is temporary and the price increases are not indicative of past situations where the carbon fiber industry gouged commercial applications waiting for the aerospace market to come back.

And by the way, we are essentially alone in this strategy, which is part of the reason why we're really the only alternative carbon fiber supplier to the aerospace manufacturers.

The other important thing that we're trying to do is look at value-added products like prepregs or fabrics made out of our fibers -- prepreg meaning resin added to our carbon fibers in our own

factory and sold as a pre-impregnated fiber. There are two reasons for this. There is an opportunity to increase our revenue, as well as our margins, and the other one is that we want to make sure that we can eliminate the possibility of being squeezed between the end user customer, the value-added producers, as the base raw material provider.

So for that reason, we need to establish ourselves in the value-added marketplace and furthermore, I think there is a danger that the value-added people make obscene margins in some cases – which we like to participate in. At the same time we like to control the end product price so that there's no sense in us maintaining a strategy to maintain a competitive pricing with other materials, while minor value additions to our product would potentially produce obscene margins and reduce the future of the carbon fiber market at the same time.

Now one important thing that we're trying to do is also to reduce our inventory, improve cash flow and maintain a better control over the inventory. Although we have a lot of pressure to increase because of our raw material supply precursor that we actually make in Hungary and there's about a four-week delay in shipping from Hungary to the U.S., so there's a lot of inventory on the ocean. And to try and maintain our inventory so that it won't grow anymore than it is, we need to reduce existing work-in-process inventory.

The final big push to increase revenue is to increase our Pyron sales. In general, the flame retardant applications have come down to the fact that whoever really wants to make a flame retardant product uses our product and whoever is just trying to marginally pass some of the test requirements can, in fact, pass them with some chemically treated fibers. So it's interesting how it develops, although there is some significant business that we are participating in already, both in the mattress industry, as well as the flame retardant clothing market.

One other effort that we have ongoing is to convert our aircraft brake customers to our own precursor for a number of reasons. One is that obviously we have better control over costs and

quality by doing so, and I might add that there is some significant effort going on to qualify our fibers for all Airbus products and there is some effort going on in selective Boeing projects, some of the biggest markets that we have.

We have found that our precursor gives 10-20% better properties, both on friction properties as well as wear properties for aircraft brakes. We have a real advantage and I also think we can assure this market going forward for decades, so this is a very important project for us.

On the operation side – switching from sales to operations – one of the top goals is to recruit a new management team – not new necessarily – additional upper management team – so that I can concentrate on the strategic issues and we could have management taking care of the operations which is becoming a very significant part of our Company and has very significant management requirements. We are close to recruiting someone for that position and should have some information on it soon.

The second thing that we're concentrating on again is to expand our capacity to meet our demand. We have a three-phase program active right now, and of course, hopefully there will be a fourth and fifth phase and so on going forward.

The phase number one was the startup of the Abilene facility, complete reactivation of the Abilene facility and precursor expansion program to meet that capacity, plus the Pyron requirements that come along with both the Pyron sales and the conversion of the aircraft brake products.

Phase two is the plan to add two million plus pounds of carbon fiber capacity, along with four million plus pounds of precursor. We are on track with phase one. Abilene is coming on line, a little more expensive and a little slower than we had hoped and planned, but it is well on its way and right now we're probably more limited by our precursor capacity being shipped from Hungary and as we get them, we can activate all the lines in the near future. We have several projects

underway to add capacity by increasing our capacity from existing lines by as much as 20%. It was very important to get financing for this phase, and fortunately we were able to get financing at \$20 a share and we accomplished that.

Phase three is for later in 2005 and this is going to be a major expansion of doubling our 9 million pound capacity by adding more carbon fiber lines, as well as 20 million pounds in precursor capacity. And this, of course, will take us through 2007 based on our market projections. Phase three, as well as phase two is really not based on expectations, but is based on existing contracts.

Fourth, I just want to touch briefly on our activity for the future. Basically as I mentioned earlier, we want to maintain our strategy in commercializing carbon fibers. This requires a huge scale-up sometime in 2007 and later. We will need to improve our efficiency of the production process, particularly efficiency of energy consumption which is fairly high, probably equal to the raw material cost and so we need to get our efficiency up.

We need to look at ways that we can do the step change increase in volume requirements after 2007. Again, we're looking at developing a value-added strategy of the products and processes we need to increase our ability to add more value to our products.

And last but not least, we need to set some financial goals – aggressive financial goals, and then set out to achieve them later this year, as well as in 2006. Obviously the initial project – or initial target is to turn profitable this year, but I think we want to look at a better rate of return and profitability going forward into 2006 and 2007.

Financing as we mentioned is done for phase two, and phase three will need more financing, but at that point if we're successful in demonstrating our profitability past phase two, I think financing will be available for us to take our steps in phase three.

We want to continue our effort to divest the Hungarian operations. I have nothing new to report there, although there continues to be several people interested in acquiring all or part of those operations.

One more important thing in the financing area – we have initiated efforts to look at how we can hedge our European sales contracts which are in Euros, and I personally think there is an increase in the price of the dollar versus the euro coming fairly soon. I don't want to make predictions, but I think we have exposure if we don't do something about hedging our Euro contracts.

Having said that, there is a significant amount of natural hedging in our Hungarian operations because lots of the raw materials and products are purchased in euros, as well as the Hungarian currency has now started to track the Euro rather than the Dollar as Hungary became part of the European Union.

That completes my report. So at this point I'd like to open up for any questions that you may have.

Operator: Thank you, sir. The question and answer session will be conducted electronically today. If you would like to ask a question, you may do so by pressing the star key followed by the digit one on your touch-tone telephone. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again, that is star one if you have a question. We'll pause for just a moment.

We'll take our first question from Steve Werber.

Steve Werber: Hi. Can you hear me?

Zsolt Rummy: Yes.

Steve Werber: Yes, hi. I'm relatively new to this story so I apologize in advance if some of these are basic questions, but just a variety of questions if I could.

First of all, you noted that you've seen some product cancellations because of carbon fiber shortages and some price increases. Can you just give a little more color on that, what areas you've seen that in and how concerned you are as you look into 2005?

Zsolt Rummy: This is not a concern for 2005; it's more a concern for 2008 and beyond. Basically what happened to us in the past is that we introduced the strategy to the market of commercializing carbon fibers and our legs were cut off by the aerospace carbon fiber manufacturers by actually lowering their prices beyond our projected price structure. And this is what caused us a lot of problems in past years.

And so as the requirements for aerospace fibers increased, these guys are abandoning the commercial carbon fiber business, and in some cases they either tell the customers that they're no longer interested in their business and/or increase the prices so much so that the people are very concerned about ongoing business.

We're trying to essentially reassure the industry that there is an ongoing idea to support the commercial fiber business. For instance, we have had some people that canceled equipment orders because they were not sure that they can get carbon fibers if they buy the equipment and so there's clearly some evidence that people are concerned about the future. That's one thing that we want to assure customers and people that have longer term projects that this change that occurred in the past year is really a shift of the market into commercial areas and we continue to maintain our objective to support.

This is not an immediate problem, but it's a potential problem in 2008 and beyond.

Steve Werber: Who is involved? Which other producers -- carbon fiber producers are involved in non-aerospace projects. Who is your competition outside of the aerospace sector?

Zsolt Romy: Well, actually with recent acquisitions and announcements, we're really almost alone. The two companies that were more or less competitors were SGL and Fortafil, and Fortafil has been acquired by Toho who is really changing their market and changing their business to be more compliant to Toho's business which is getting away from the commercial market. And then SGL just recently made an announcement of getting some technology and supporting Mitsubishi Rayon which is also more targeting the specialty aerospace fiber.

So it looks like for the time being we're almost alone in this commercial market.

Steve Werber: Do you think it would actually help the industry though if you had more competition so that your people you're working with in this area would have more comfort that there will be a healthy supply and healthy sort of R&D and investment in this whole area?

Zsolt Romy: Yes, I think we're looking for somebody to surface that will whole-heartedly support the concept and do it professionally. We're very pleased that the aerospace guys have finally demonstrated that they're not going to be the ones to do this.

So I think we're in a phase of change, and my hope is that we have about a two-year window here that we can establish ourselves as being the prime leader in this market and we'll be able to maintain that position for a long time. But at the same time, I'm hoping that there will be a very good competitor entering into the market.

Steve Werber: OK. And then I did see an announcement by Tech-Fab in Anderson, South Carolina that they've been working with patented carbon reinforcing grid for concrete ...

Zsolt Rummy: Right.

Steve Werber: ... I'm just wondering if you can comment. Using your materials, I'm just wondering if you can comment on when that might be something we'll see in the marketplace, and how excited you are about that?

Zsolt Rummy: Well, first of all it's in the marketplace now. This is a project just like the wind energy projects that has been going on for some time and it finally came to fruition. It's a precast concrete group that we've been working with for years and finally they've put together a consortium and they're introducing a whole line of products that are precast concrete walls for buildings, as well as precast concrete high beams and sections for parking garages and things like that.

These guys are extremely big and have a pretty good handle on the precast concrete market, so I think they have huge hopes for the future and we're already selling into that market. We expect a significant growth this year and even more significant growth next year.

Steve Werber: Can you just roughly quantify in terms of your sales what portion could be to that market this year if it's successful?

Zsolt Rummy: I really don't want to speculate on those kinds of things.

Steve Werber: OK. But I mean, is it material to your future growth, or is it sort of a small ...

Zsolt Rummy: No, it's material and it's also representative of several other customers that are doing similar projects in – let's say, in concrete repair and other road construction projects other than the precast concrete.

Steve Werber: OK. Just one last question, and I'll let someone else have a chance. Just on the operating working capital this year and the big inventory increase in this last quarter – for the full year do you expect working capital will be positive or a negative impact on cash flow, and if you can sort of help us understand how much that could be.

Kevin Schott: In the long run, I think the working capital factor will be pretty flat. I think you'll see inventory reductions going forward. As Zsolt mentioned, we have some projects ongoing related to old inventory that should offset some of the increases you'll see in our raw material.

You will obviously see a sales increase. We will have receivable and payable issues, but you will have to remember that we do have revolvers set up both in Hungary and the U.S. that will allow us to offset any working capital issues related to increases in receivables and changes in payables allowing us to offset those increases or decreases.

Steve Werber: Thank you.

Operator: And once again, that is star one if you have a question. Our next question comes from Dominick Golio.

Dominick Golio: Yes, I had a question about the manner in which you said earlier that you were going to dedicate 70% of the sales or capacity to fixed contracts and the balance to the discretionary pool. Does the concrete business fall into this discretionary pool?

And then also, I had difficulty understanding with all of the sales that we have, why is there this inventory management issue?

Zsolt Rummy: Well, on the first question – I don't know if I want to call it dedicated or discretionary. I more want to indicate that we're trying to gauge our capacity expansion so that we have contracts

against those expanded capacities and we want to limit our risk of making any investments so that we have enough sales or enough capacity available to support any new projects. At the same time, we need to have some assurance that the business is there when we make an investment in expansion.

As far as the inventory situation, I'll let Kevin answer.

Kevin Schott: First of all, I want everyone to understand that a significant chunk of that increase was related to the gain in Hungarian forint versus the dollar. We keep our inventory in Hungary in forints and as the forint increased against the dollar that caused significant change. So it really isn't significant – it was a non-cash change and that's going to happen as the dollar and forint increase and decrease.

The second change was related to our Pyron product. That was just a seasonality impact where our major customer shut down their facility for that period of time and we continued to produce to build some inventory for them, and that will swing as of the end of the March quarter.

The other piece of the puzzle is we do have inventory that relates to the major produce we're supplying right now which is called our tow product – carbon fiber tow – which there is no buildup in. The inventory that has existed is in different types of products -- our milled products and our chopped products – there has been some sales increases in that, but at this point in time not enough to decrease inventory significantly. As Zsolt mentioned, we have some projects in place to decrease that inventory.

The third thing is that we are building our precursor plant and our precursor capacity. That consists of building raw materials to be able to supply seven lines worth of carbon fiber. When they produce the raw material in Hungary, it has to be shipped over to Abilene. That's usually a four-week delay. So that is showing some increase in our raw material. Again, I would say that

you will see some change in the inventory going forward in future quarters. It will be reduced and level out a little bit, but as we continue to increase capacity and the precursor plant has continued to buy raw material, you might see a slight increase going forward.

Dominick Golio: OK. Thank you very much.

Operator: As a reminder, that is star one if you do have a question. We'll pause for just a moment.

Take a follow-up from Steve Werber.

Steve Werber: Hi, I just got back in the queue. I just want to clarify the gross margins. Was I right in hearing that you said you see it improving sequentially throughout this fiscal year?

Zsolt Rumy: Yes, we will see the gross margin on the product increase going forward as we improve the efficiencies in the carbon fiber lines in Abilene, along with the efficiencies in our precursor production.

Steve Werber: And within that, what kind of carbon fiber pricing – sales pricing assumptions are you looking for this year?

Zsolt Rumy: We don't talk about sales pricing in these conference calls or any other time. It's really not something that we want to publish in the financial world – but clearly we are looking for increased value-added products to increase our margins. We're also looking to increase our margin on our base fiber by both reducing the cost and as required by our cost reducing increases that we cannot control such as raw material and energy, so we make sure that we have a way of increasing our selling price to cover for those increased costs.

Steve Werber: And when you say we should see a sequential improvement in the gross margin, at what point does that go above the 14%, and can you talk a little bit more about medium term, where you think gross margins should be if you're running your processes efficiently, etc.?

Zsolt Rummy: Well, I think we may have published before that we're looking for a minimum of 30% gross margin for the long term in order to maintain our investment and return on capital.

Steve Werber: OK. And will the gross margins go above 14% this year or is that...

Zsolt Rummy: Oh, I would definitely think so ...

Steve Werber: And then also on capital expenditures, you said it would be increasing on a quarterly basis as well. I was wondering if you could give a little more detail to what you see as the cap ex this year.

Kevin Schott: We had \$2.5 million in the first quarter this year. And we basically have made the comment in prior conference calls that a new carbon fiber line basically around \$5 million. We're putting in two carbon fiber lines, so you can do the math.

Secondly, we're obviously increasing the precursor expansion to meet the demand of the two new carbon fiber lines, so that will also be some capital expenditures related to that increase at the same time.

Steve Werber: OK. And I did have a question on the convertible deals you've done in the past. It looked like there were a lot people on the Board that were actually buying these convertible shares ...

Kevin Schott: Yes.

Steve Werber: ... and I'm just wondering if this was in fact, just a way for the Board to buy stock, because essentially they've converted into shares and in the meantime they got paid an interest sum. Can you help me understand the placing of these deals and if that analysis is correct.

Kevin Schott: Sure ... The major one was done in February of 2003 which was a major commitment from Board members. That was in February 2003 for \$8.1 million. Although I wasn't here at the time, I will say at that point in time where the Company was at, to raise \$8.1 million, that would be basically the only way they were going to raise \$8.1 million ...

Steve Werber: Right.

Kevin Schott: Subsequent to that time, the deals done in January and March 2004 did have a small number of Board members that participated in those deals, but not nearly as much as the \$8.1 million deal.

Zsolt Romy: ... in any event, to characterize it as a way to buy shares is really not true, and as a matter of fact, quite the contrary. Two years ago the Company was probably at its low point; it wasn't clear whether our strategy was working or not. It wasn't clear where our revenues would come from, our banking relationship was at a low point and we had to raise some money, and frankly, the Board members and some friends that participated in that offering have really virtually saved the Company at the time.

So to characterize it as a way of taking some cheap shares I think is very unflattering and not true.

Steve Werber: OK. No, I didn't mean to suggest it was in a nefarious way.

Another question. In a research report I read, there's a lot of hope for sales into home furnishings and mattresses, and you touched on it, but I'm just wondering if you can give us an update, particularly on the legal regulatory side and how you think you're positioned competitively versus chemicals and other solutions – what the outlook is there.

Zsolt Romy: Well the California regulation reduced the requirements significantly. As I mentioned on a past call, they had reduced the time of flame exposure by half, reduced the opening burning time to half – opening burning meaning if the mattress burns, and the original plan was that the mattress can burn for an hour before the flame actually gets into the internals where the foam is, where the high energy fire comes from -- and they reduced that amount time to 30 minutes rather than an hour. They doubled the amount of energy given off during that time of burning before the test is completed.

So what that did is allowed chemically-treated products to come up to a minimum standard of meeting these specs. The federal government is now in the process of setting their test results or test process and that's not completed yet. There is clear indication that they're going to be somewhat more stringent than California was, but we don't know yet. That regulatory step is being done right now and should be completed sometime during 2005.

In the meantime, what we have received is a couple of contracts from juvenile mattress manufacturers for crib mattresses and so on, and the general comment is that we know we can pass the standard with chemically-treated materials, but we're responsible and we really want to have a flame-proof mattress and the only way we can reach that goal is by using our Pyron products.

In addition to that, there is a lot of discussion about the fact that the chemical treatment for fiber has potentially more mass hazard than individual fires do and so it's pretty well open as to what's going to happen and I think it's going to determine itself in the next 12 to 24 months.

But frankly, we will have a position in that market, maybe not as much as we had hoped originally, but we'll have a significant position.

Steve Werber: And what is the rough price differential between a chemically-treated and a carbon fiber treated ...

Zsolt Rummy: I think it is highly irresponsible of the product manufacturers to oppose the standards, and they are fighting the stringent standards and it's one of those things that may require a catastrophe to change the attitudes.

Steve Werber: OK. Thank you very much.

Operator: Our next question comes from Andrew Bugyis.

Andrew Bugyis: Can we go back to this reinforcing grid for concrete for just a minute?

Zsolt Rummy: OK.

Andrew Bugyis: What attributes does this produce have in order to expect that these folks are going to get an increased share market versus their alternative materials. Is this basically earthquake material or what is it?

Zsolt Rummy: There are a lot of benefits for carbon fibers in construction. The earthquake benefit is not related to this particular grid process, but it is related to wrapping bridge columns which is ongoing and we have other customers on that, and if we ever get a very significant contract, we will announce significant contracts. But we do have ongoing business in those areas.

This particular grid system is primarily just for replacing concrete that has no reinforcement in it and/or replacing steel-reinforced rebars, so it has a number of advantages. In a facade for buildings it can change six-inch thick concrete to maybe 2-inch thick, so you can see the tremendous weight reduction and still have better properties, better strength and better stiffness, reducing the amount of weight the building has to carry, construction costs and so on.

In a parking lot in the north, you can see exposed steel grids and chipped concrete and that comes from two things – corrosion when the steel corrodes as salt gets down there and expands and chips off the top of the concrete, so you've got huge maintenance issues as well as huge weight reduction results from using the carbon fibers. So there are all kinds of tremendously good selling points for using this grid in precast concrete.

Andrew Bugyis: OK. Let's move to the attractiveness of having an alternate source of carbon fiber that could alleviate some of the user's concern about having a single source supplier and what could happen if you people had any kind of shut down in production for whatever reason.

Do you think you're goal of – I mean, people are attracted into industries by their belief that they're going to make a lot of money. That's the capital way. Do you think these 30% gross margins are enough to attract additional competitors?

Zsolt Romy: I think it is and I think that there's a tremendous amount of downstream products that are profitable, so the attraction is there and the volume is going to grow significantly. Obviously return on investment is very important and we're going to be dealing with that as we grow because it's a fairly tactical intensive business.

But you know our goal has always been to hopefully get a two year's jump on anybody else that seriously follows what we're doing so that we'd have the first mover advantage, and I think we're fairly sure that we're going to have that. And there is a lot of activity going on for other people to get into the market, but it's just the nature of the beast even if somebody decided today to compete with us directly, it would take at least two years to put together a production line, gear up and start up.

I think we're pretty well assured to have the first mover advantage. But I think there is a lot of activity going on out there that indicates that we will have some serious competition going forward.

Andrew Bugyis: OK. Your financial guy mentioned \$5 million to build a line to increase productions.

Does that equate to 5 million pounds?

Zsolt Rummy: No. Our lines right now are about 1 million pounds, a little over a million pounds.

Andrew Bugyis: OK. With your future funding that you eluded to continue your expansion behind the capacity to fulfill sales through 2007, if you are in the process of flip-flopping your balance sheet and getting the leverage down, could that funding be debt as opposed to equity that may dilute this thing again?

Zsolt Rummy: We were hoping not to do any more convertible financing because there's a little more dilution than I like to see and then a little more expense. But at the same time, I think at this time we didn't have much of a choice and as we increase the conversion price the dilution significantly decreases.

So we're looking to do both, regular bank borrowing as our balance sheet strengthens with the conversions, as well as our profitability starts going up, then we will have a much better opportunity to do conventional borrowing, and so we have full intention of utilizing both equity as well as financing.

Andrew Bugyis: All right. One more question. In these historic funding processes where Directors were a significant portion of the funding, anybody else could have bought the stock on the same terms as the Directors, right?

Zsolt Rummy: Absolutely.

Andrew Bugyis: OK.

Zsolt Romy: As a matter of fact, Directors paid more, significantly higher mark-up over the current market than any of the subsequent investors.

Andrew Bugyis: OK. Thank you.

Operator: As a reminder, that is star one if you do have a question. Once again, we'll pause.

Mr. Romy, at this time there are no further questions. I'll turn the conference back over for any additional or closing remarks.

Zsolt Romy: OK. Thank you very much. I'm glad to see all the questions came from some new people that follow us and that's exciting. And thank you for your participation.

Operator: And that does conclude today's teleconference. Thank you, have a great day. And you may now disconnect at this time.

END