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CDTI - Q3 2015 Clean Diesel Technologies Inc Earnings Call

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CORPORATE PARTICIPANTS

Becky Herrick *LHA - IR*

Matthew Beale *Clean Diesel Technologies, Inc. - CEO*

David Shea *Clean Diesel Technologies, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Matt Koranda *ROTH Capital Partners - Analyst*

Rob Brown *Lake Street Capital - Analyst*

Amit Dayal *Rodman & Renshaw - Analyst*

Ian Gilson *Zacks Investment Research, Inc. - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Clean Diesel Technologies, Inc., third-quarter 2015 financial results conference call.

(Operator Instructions)

As a reminder, this conference is being recorded.

I would like to introduce your host for today's conference, Ms. Becky Herrick of LHA. Ma'am, please begin.

Becky Herrick - *LHA - IR*

Thank you, Nancy. Good morning, and thanks to everyone for joining us. By now you should have received a copy of our 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 page of our website at www.CDTi.com.

Before I turn the call over to Matthew Beale, Chief Executive Officer of CDTi, I want to emphasize that some of the information you will 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 differ materially because of factors discussed in today's results press release, in 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 obligation to update any forward-looking statements.

Now I'd like to turn the call over to Matthew. Matthew, please go ahead.

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

Thank you, Becky. Good morning, everyone, and thank you for joining us today.

Before we get into the quarterly review, I would like to note that my appointment as CEO comes at a time when the market environment has never been more favorable for CDTi's technology. Automotive emission controls and standards are under intense scrutiny globally. Increasingly stringent standards continue to raise the cost of compliance for industry participants. That we have validated and proven solutions that allow the industry to meet or exceed requirements while reducing cost could not be more relevant. CDTi's mission, therefore, could not be more relevant.

However, as a manufacturer of catalysts, CDTi can only partially fulfill its mission. Its size and scope have necessarily limited its ability to deliver its solutions more broadly. Despite the universal applicability and recognized innovation of CDTi's low-PGM solutions in an automotive context, its manufacturing focus and the attendant resource allocation implications have limited the Company's capacity to grow and diversify its revenue base.

CDTi is truly world class at two things: the material science of catalyst formulations and high-volume, light-duty automotive catalyst coating. While the accumulated know-how of being world class at both of these things is perhaps the Company's most valuable asset, CDTi adds more value to more customers in more markets as a focused pure play advanced materials technology Company.

We have talked at length in previous calls about our advanced materials focus and powder-to-coat business model. Following an intense investment cycle in new technology, CDTi's resource allocation is now heavily weighted towards market-specific applications and commercialization. The strength of our product offering and the quality of our new business pipeline now position the Company to accelerate completion of its business transition. This transition will involve significant change on two levels: organization and infrastructure, and revenue composition.

As it relates to our organization and infrastructure, we are currently finalizing plans to restructure and reposition our operating footprint in support of our strategy. Those plans include initiatives that would result in exiting non-core businesses and externalizing operating activities that are not integral to delivering value for CDTi's customers. We believe these steps will have significant positive impact on the ability of the Company to achieve sustainable profitability. We will be providing details of these activities in a series of announcements that will likely begin prior to year end and be completed before our next earnings call.

Revenue composition will also change significantly over an 18- to 24-month period. Most notably, we will be winding down our light-duty high-volume catalyst coating activity with the completion of current vehicle programs we have with Honda in the second half of 2017. We will, of course, continue to pursue business with passenger car OEMs, including Honda, going forward, but will do so where consistent with our powder-to-coat business model.

As mentioned above, our advanced materials strategy will allow us to deliver value to more customers in more markets. However, consistent with our transition to a streamlined and focused operation, we have been disciplined in identifying the opportunities we will pursue, and that will contribute to a more diversified and growing revenue base.

Now I'd like to touch briefly on our new business pipeline, by major initiative. The North American aftermarket is a large and highly sophisticated automotive ecosystem that plays to CDTi's strengths. Our ability to deliver OEM-validated technology in this channel is a major differentiating factor, and is driving the expansion of our commercial pipeline in chosen segments. The heavy-duty diesel segment in class 5 day trucks in particular is an attractive market for us, and where we've established our DuraFit-branded DPF, and soon to be launched DOC products is a technology and quality leader in the OEM replacement market. As mentioned in a recent press release, we believe this segment offers a total market opportunity in the realm of $450 million.

Thus far in 2015, we have rolled out a multi-channel distribution network, and expect to meet our initial revenue targets. Notable in this regard is our recent distribution agreement with PACCAR, a heavy-duty market leader under the Peterbilt and Kenworth brands. We will expand our distribution network further in coming months, and believe we have created the foundation for a revenue stream that can multiply over the near term, with evidence of this trajectory emerging during the course of 2016.

We are also targeting the light-duty OEM replacement market where we can deliver OEM-caliber technology and significant PGM savings to exhaust manufacturers. Increasing adoption of CARB standards outside of California, and the PGM loadings necessary for compliance, creates a highly favorable environment for application of our technology. This is a large and vibrant market of over 2 million exhaust systems per year, and the CARB-compliance product segment where our technology is most relevant is growing faster than the overall market. We are addressing this opportunity through our collaboration with major North American exhaust manufacturers, including AP Exhaust. Our BMARS technology delivered in powder-to-coat form complements our partners' manufacturing expertise in this segment. Based on our product development and certification timelines, we expect revenue visibility from this market to grow throughout 2016.

In India, we are engaged in discussion with potential OEM partners regarding deployment of our SPGM DOC technology for commercial vehicles on a powder-to-coat basis. This is a large and rapidly growing market of approximately 500,000 vehicles. Our ability to provide low-PGM solutions that support the transition from domestic emission standard BS-III to BS-IV in 2016 creates a fertile market for our technology.

We are currently performing initial vehicle testing, and expect to provide more color regarding this market opportunity in the coming months. We would anticipate initial revenue visibility in the latter part of 2016. Longer term, we see a significant powder-to-coat opportunity at the 3 million vehicle per year OEM passenger car level. The commercial vehicle initiative currently under way is an important stepping stone.

In China, we are in advanced discussions with powder-to-coat customers in the heavy-duty diesel segment. We see ample opportunity to deploy our SPGM technology in a market that produces approximately 1 million heavy-duty engines per year. Leveraging our success in this market, we obviously perceive enormous long-term potential in serving the 20 million vehicle per year passenger car market through our powder-to-coat strategy. In this segment, the largest passenger car market in the world, we have initiated vehicle testing with a domestic OEM on a popular light-duty model, and will report progress in coming months.

Last but not least, and although we will no longer pursue high-volume light-duty catalyst coating opportunities, we will continue to work with leading global OEMs and their suppliers to deliver our technology through our powder-to-coat capability. Our long-standing relationships and history of innovation position us very nicely to transition seamlessly from tier 1 supplier to technology partner.

To summarize, we expect to transform our revenue base over the next 18 to 24 months, while streamlining our operations around a powder-to-coat focused business model. That transformation will gain increasing visibility during the course of 2016. Longer term, we perceive enormous incremental revenue potential as a provider of next-generation, low-PGM catalyst formulations for the global passenger car market. We look forward to keeping you updated on our progress.

I will now turn the call over to Dave for a detailed review of our Q3 financials. Dave?

David Shea - *Clean Diesel Technologies, Inc. - CFO*

Thank you, Matthew. As a reminder, the Standard Exhaust business, which was sold in October 2014, is classified as discontinued operations.

For the third quarter of 2015, revenue was $9.8 million compared to $9.3 million in the third quarter of 2014. DuraFit sales were $1.7 million for the third quarter, as compared to $0.1 million for the same period last year. We remain on target to meet our goal of $5 million in DuraFit sales in 2015. Retrofit sales were $0.6 million, as compared to $1.7 million last year, as retrofit sales continue to decline. Catalyst revenue was $6.7 million, up 8% compared to the $6.2 million in the third quarter of 2014. The increase reflects growth in new car production volumes for Honda, and product mix.

Gross profit was 25% compared to 31%, reflecting the launch cost associated with our new DuraFit product line. As DuraFit sales ramp and we gain efficiencies in our supply chain, we expect incremental improvements in margins. Margins were 20% for the heavy-duty diesel and 27% for the catalyst division for the third quarter of 2015. If we back out the pass-through revenue tied to ceramic substrates onto which we coat our proprietary catalyst formulations, gross margins for the catalyst division would rise from 27% to 43%, showing the true value add of our advanced materials and precision coating.

Total operating expenses were $5.3 million for each period. Breaking down the operating expenses, SG&A was $3 million compared to $2.7 million, reflecting higher payroll-related and consulting costs as we pursue new business opportunities. R&D was $2.3 million compared to $1.8 million. R&D expense increased as a result of testing and development work on new advanced catalytic materials. Severance and other charges were $0.8 million in the prior-year quarter.

Operating loss was $2.9 million compared to $2.4 million in the same period last year. Net loss was $2.2 million or $0.13 per share compared to a loss of $1.6 million or $0.13 per share in the same period last year.

The weighted average outstanding shares for the third quarter of 2015 were 16.8 million, as compared to 12.4 million in the third quarter of 2014. The increase reflects the approximately 2.5 million shares in the $5.1 million offering we conducted in June of 2015, and the 1.4 million shares in the $4.4 million offering we conducted in November of 2014. At September 30, 2015, we had cash of $3 million as compared to $7.2 million at the beginning of the year.

Subsequent to quarter end, we amended our loan agreement with Kanis SA to extend the maturity dates from October 1, 2016, to October 1, 2018. This provides for greater flexibility as we execute on our growth strategy.

We are reaffirming our annual guidance for 2015. We continue to expect revenue between $40 million and $45 million. This compares to the $41 million in 2014.

We expect gross margin to be at the high to mid -- the mid- to high-end of our guidance range, which is between 25% and 28%. As Matthew mentioned, we are assessing several opportunities to better align our Business with our goal of profitable growth.

With that, I turn the call back over to Matthew.

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

Thanks, Dave.

I've been in my new role at CDTi for three weeks now, but clearly perceive an Organization excited to accelerate its strategic and operational transformation. Once completed, the potential to leverage the Company's unique technology across applications and geographic markets that it could not reach as a manufacturer is enormous.

Thank you for your time and interest, and we look forward to keeping you informed of our progress. Now we'd like to turn the call over, operator, please, for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Matt Koranda, Roth Capital Partners.

Matt Koranda - *ROTH Capital Partners - Analyst*

Just wanted to start out with guidance. I wanted to assess your confidence level in the revenue projection you have.

I think the midpoint of your guidance implies about $12.5 million in revenues in Q4, which looks like a little bit over $2 million better than your best quarter this year. Maybe you could run through the assumptions for us and puts and takes there.

David Shea - *Clean Diesel Technologies, Inc. - CFO*

As far as our guidance, the range $40 million to $45 million, we're probably a little bit under -- to hit the low end or the midpoint as you talk about, the catalyst division is expected to run pretty much similar to what we saw in the third quarter. I think we will have a pickup on the diesel side as we bring DuraFit really up to speed and we start to see the benefit of the PACCAR agreement.

Matt Koranda - *ROTH Capital Partners - Analyst*

Okay, got it. In regards to DuraFit, I think you may have mentioned, it but I may have missed it, how much revenue did you have from DuraFit on the quarter?

David Shea - *Clean Diesel Technologies, Inc. - CFO*

$1.7 million.

Matt Koranda - *ROTH Capital Partners - Analyst*

$1.7 million, got it. Could you just talk about the warehouse strategy? I know you said you opened I think four distribution warehouses to support the roll-out of it DuraFit. Maybe you could highlight for us how many you have in total now, and I guess what are the fixed costs associated with those facilities on an annual basis? Is there any significant cost to those? Could you help us understand that?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

Yes, first of all we have the four regional distribution warehouses in addition to our own. The warehouses are sitting within the facilities of our certain distributors. So the fixed cost is not there. It is all a transactional-based arrangement.

Matt Koranda - *ROTH Capital Partners - Analyst*

Okay, got it. I wasn't a clear on that in the release. Then, could you give a little more color on the PACCAR agreement if you could here?

Are there minimum volumes associated with it? What does pricing look like relative to what you had expected and what you put out on the past calls? Maybe a little color there would be helpful.

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

Yes, there is no minimum volume in the agreement. Pricing is similar to what we've talked about in the past.

Matt Koranda - *ROTH Capital Partners - Analyst*

Then, one last one on DuraFit. Gross margins, I think you called out in DuraFit as creating a drag on the quarter here.

Could you just help us understand specifically what those margins were in Q3 and then how should they improve as you scale into Q4? The implied revenue for Q4 for DuraFit is probably somewhere north of $2 million. Is that fair to say?

David Shea - *Clean Diesel Technologies, Inc. - CFO*

Yes, so from a revenue standpoint, I think you are in the right ballpark there. From the margin standpoint, we really don't want to talk about that in detail from a competitive standpoint. But clearly it's not where it needs to be, but as we ramp up the volume -- you look at that product and the single most expensive thing is the substrate.

Pricing on that is very volume dependent. As you can see with PACCAR bringing on 600 plus outlets, that will lead to some definite acceleration, particularly as we saw in Q3, a doubling of sales -- almost a doubling of sales versus the prior quarter. That's really what will help us bring that down.

Matt Koranda - *ROTH Capital Partners - Analyst*

Okay. Got it. One last thing from me on the cash management front here. I thank you said last quarter we might start to see a narrowing of loss from cash used in operations, but I think it increased a bit this quarter. AR and inventory were both uses of cash.

When do they start to generate cash? Do you think you can do that in Q4? And where are we in terms of the cast position year end?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

As far as -- we had big pickups in AR in inventory, about 400,000 in each of those over the quarter. We had a disproportionate amount of our sales for Q3 at the end of the quarter. And further, we were ramping up inventory to start to be able to serve PACCAR and to be able to put inventory out into the warehouse we talked about earlier.

Also, additionally when you look at cash usage in the quarter, I want to point out that, if you remember back to the Q2 call, we talked about a settlement with Johnson Matthey related to the sale of AUS, and there was $600,000 of cash that was consumed in relation to that. To with that, I think we will start to see a leveling out of the AR and inventory as we move into the Q4.

David Shea - *Clean Diesel Technologies, Inc. - CFO*

And Matt, I would add to that, we just talked about in the prepared remarks and obviously in the earnings release a very significant shift, strategic shift and organizational shift as we go forward. We will be announcing from between now and the end of the year and out to the next call. That will change very much the profile.

I think it will be more helpful as we have greater visibility into some of these initiatives and revenue things come online. We need to start looking at cash on a more strategic basis and how it fits into the context of the new strategy. So I think that will be coming online in the coming weeks as well. There will be more inputs.

Matt Koranda - *ROTH Capital Partners - Analyst*

That's helpful. Maybe if I could on that more specifically, can you just give us a little bit more flavor in terms of what you mean by exiting non-core businesses?

It sounded to me like in terms of the businesses the you have on a go forward basis, obviously powder-to-coat model and DuraFit, what's left that's non-core aside from the catalyst coating side of things, which potentially is winding down with Honda by the end of 2017 I think you said? What else is left to monetize there?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

There's a number of smaller lines of business that we have. Customer business, some that's winding down. I would highlight, obviously, the retrofit business falling into that category.

So when we say exit, it can be a number of things. It could be, as you mentioned, monetizing. It could be winding down. It could be outsourcing. There are a number of ways to deal with some of those business.

I think the overriding principle here that we're looking for again is to increase focus and to maintain a significant footprint to support a variety of small businesseses is not what we're looking to do. So again, the focus here is that we've identified from DuraFit and some of the roll-out internationally, we're taking a long hard look at -- in addition to the businesses, what we need to do to add value and be successful in those segments. A little bit of an elliptical answer, but I think news will be forthcoming here in the coming weeks.

Matt Koranda - *ROTH Capital Partners - Analyst*

Understandable. Thanks for that and congratulations, Matthew, on the new position.

Operator

Rob Brown, Lake Street Capital.

Rob Brown - *Lake Street Capital - Analyst*

On the AP Exhaust business, could you remind us the timing of that ramp and how that unfolds in 2016?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

I think it's helpful to think about that also in terms of the broader North American aftermarket. I think we are good at specifics, but it's also -- I think generally that's a market that we are pursuing the aftermarket exhaust business, the three-way catalyst and we're looking at a variety partners including AP.

And I think that will continue to gain visibility in 2016. You've got an EPA product category and a car product category, and probably the former will gain more traction more quickly mainly as a result of certification processes and some complexity. But overall, that area and the agreement you cite and the collaboration there is what's going to drive our ability to penetrate that market, which is really unexploited right now.

Rob Brown - *Lake Street Capital - Analyst*

Okay. Good. Could you go into a little more color on the wind down of the catalyst coating business?

Do you see that continuing with Honda, but under a different manufacturing model? Or is that to be determined, or how does that play out? What does that mean to the Honda business?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

Yes, I think we have a number of models that we are currently working on, and those go out through the middle of 2017. And we will continue to provide the level of service and quality that we have and continue to be an integral partner with Honda in pursuing that business.

I think after 2017, the second half of 2017, that will not be our area of focus in looking for high-volume light-duty catalyst coating. At that point, our dialogue -- it doesn't start later, it starts now -- with partners such as Honda in that area. We will focus around what we can deliver under our powder-to-coat strategy.

I talked about two things that we're really good at. One is the material science of catalyst formulation. The other is catalyst coating on a high-volume level.

I think the former is where we truly add value for our customers. The latter -- I think we are world-class at doing it, but we don't truly add value because we aren't global. We can't scale with our customers. We don't have eight plants located strategically around the world.

Fortunately there are a number of other companies that are structured to do that, and that is their core business. That gives you a little bit of the context for the shift in the dialogue. I think we will -- through the middle of 2017 -- our current activity will continue.

Our dialogue and strategic partnership in looking for ways to deliver our technology, which again is why we have the relationships in the first place, will evolve during that time. And again, we see tremendous opportunity and may be more beneficial to our customers, the ability to deliver the technology in powder-to-coat form.

Rob Brown - *Lake Street Capital - Analyst*

That's good.

I know you said some of the details would be more forthcoming, but what is your high-level target on cost savings here or what do the strategic shifts do, in terms of timed profitability?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

I think it's difficult to be specific. We've got a good handle on where we're headed. There's two sides; there's obviously the organization and the cost side, and we will be able in coming weeks to provide a lot of color in that direction. The initiatives we're taking and the ability to execute those initiatives will be very -- is transparent and clear.

On the revenue side, again, as we move -- as our mix shifts more to a powder-to-coat model, we believe that profitability -- at least the marginal profitability is higher and again will contribute to cash. I think both of those things taken together over the next 18 to 24 months will transform that profile.

I think it's more helpful if we can lay that out in the context of a number of these initiatives. Our desire -- the intensity with which we are trying to pursue the profitable growth scenario on a more diversified customer and user market basis is front and center. And there will be two sides to that equation, but I think we will be able to lay out clearly that path that we will be marching down over the next 18 to 24 months.

Rob Brown - *Lake Street Capital - Analyst*

Last question -- you did a good job of laying out the India and China opportunities. Maybe on the time line, is it visibility on revenue in 2016? Does that mean actual revenue following that, or maybe give a sense of when you could see actual revenue in those emerging markets.

David Shea - *Clean Diesel Technologies, Inc. - CFO*

I think visibility on revenue and potentially initial revenue as well in 2016. That's really what we're targeting.

One of the beauties of India and some of these other markets is the time to market -- the product lifecycle is a lot quicker. And we are able to work together with our OEM partners, many of them integrated in the sense that they have a very integrated supply chain. In that respect we're able to deliver far more quickly technology and implement and be in the market, get through testing than we are in some other markets.

There is a theme here that I want to highlight, as well. You will notice that we laid out the business that we will be pursuing, and clearly as well the business that we won't be pursuing, and that is driven also by the ability to serve markets that we perceive as being ill-served or not ideally served over the short term. And that provides us a chance to really gain traction with the powder-to-coat model. The initiatives we've laid out we think are consistent with that criteria.

Operator

Amit Dayal, Rodman & Renshaw.

Amit Dayal - *Rodman & Renshaw - Analyst*

On the DuraFit side, are there any distributors who are accounting for a larger portion of sales or expected to do so?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

Could you repeat the question? Sorry -- on the DuraFit side, are there any distributors that are -- I missed the last part. My apologies.

Amit Dayal - *Rodman & Renshaw - Analyst*

That account for maybe a majority of the sales right now and maybe would account for the majority of sales in the future? I know that PACCAR is a big player in the space.

How much revenues were generated through them in the past quarter, if any? And what the outlook is in terms of larger distributors accounting for a larger a portion of the DuraFit sales.

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

We talked about the multi channel distribution strategy for DuraFit. You have the OES segments, which is the OEM service part of which PACCAR would be a good representative of that. You have the independent distributors and you also have retail. Kind of in that order would be the way that our target market is segmented in terms of volumes.

I don't think over the short term here it would be difficult to point to -- there's not a lot of historical data as of yet, but I think it would be difficult to point to one segment immediately as representing the lion's share. The OES segment, I think, is a newer segment and one that we are very excited about the prospects. Currently if you segment the market, that is where the dollars are.

So, our efforts to -- in that area, along with the others, I think, will provide the most visibility to revenue going forward. We have begun shipments with PACCAR recently over the quarter if I'm not mistaken, Dave.

David Shea - *Clean Diesel Technologies, Inc. - CFO*

Yes, we have begun shipping to PACCAR in Q4. There was no shipment to PACCAR in Q3, but we announced in September.

Amit Dayal - *Rodman & Renshaw - Analyst*

Okay. In relation to the powder-to-coat business, you seem optimistic on that front. Could you give us some color around some of the news flow-related items potentially coming up that you highlighted at a higher level? Are these going to be around actual shipments beginning to see customers like AP Exhaust, or are these going to be around new partnerships you are pursuing and potentially will close on?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

Yes, it's all of the above. You highlighted it nicely. All of those initiatives in addition to new arrangements.

We did highlight in the call the dialogue we have both in China and India, again with a very clear powder-to-coat endgame. I think we mentioned initially we will have our first powder-to-coat shipments to a customer by the end of the year, and we continue to believe that will happen. We continue believe that will be the case.

That's something if you're looking for milestones to look for, that's a good one. And into early 2016 we think there is very solid news flow. We've stressed the powder-to-coat business, some of the initiatives that we're on, which are primary, and I think that just reflects our confidence in the ramp and potential that we're seeing in those focus areas we identified.

Amit Dayal - *Rodman & Renshaw - Analyst*

Got it. Last question -- on your opportunities in India and China, are you dealing with OEMs directly over there? Are you going through any distributors or suppliers to the OEMs?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

We are dealing directly with OEMs. We are also dealing directly with other participants in the catalyst supply chain, if you will. So it's really a top-down and bottom-up strategy, which we think is critical in gaining awareness of the applications and for finding different ways to apply our technology at different points in the value chain.

Amit Dayal - *Rodman & Renshaw - Analyst*

Thank you.

Operator

(Operator Instructions)

Ian Gilson, Zacks Investments.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

I've got a few questions. Why the increase in R&D in the quarter versus prior quarters?

David Shea - *Clean Diesel Technologies, Inc. - CFO*

That was really working around vehicle testing related to things like Spinel and some of the other new technologies.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

I presume that the end of the Honda business is with the end of the 2017 model year. So basically you have six months of business and that's the first half of 2017 and then nothing in the second half? Of the current business.

David Shea - *Clean Diesel Technologies, Inc. - CFO*

The Honda business will be winding down largely in the second half of 2017. There's still some models that will be on at that point, but the majority of it will have transitioned off.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

Does that means there's also some business in 2018? Because the model years go basically as I understand it -- the building goes from midyear to midyear.

David Shea - *Clean Diesel Technologies, Inc. - CFO*

Correct. So the model year 2018 will be launched in the Honda showrooms in September, which means the suppliers will be building parts in June, July for those. So we will have some residual coating business in the second half of 2017, but it will be much smaller than our current book of business with Honda.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

Okay, why did catalysts year over year go down by $700,000 profit a year ago -- from the last current year?

David Shea - *Clean Diesel Technologies, Inc. - CFO*

So, driven by two things. One, our margin is a little bit lower basically due to the passthrough costs of the current model versus what we were building last year. Substrate changes driving that, and then the operating expenses in the business were higher primarily driven by R&D.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

Okay -- the revenues from Honda cover some overhead, I presume. Does that overhead end, or are we faced basically with a structural imbalance?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

I think the structural imbalance, I don't think is what will be faced to. Again, I think there's obviously complete visibility to the revenue we have from Honda through not complete, but very clear visibility or comparability to what -- the revenue that will happen through the middle of 2017.

I think beyond that again, we will be transitioning with them and other OEM customers to a focus that is more consistent with the powder-to-coat activities. We will transition the organization also at our infrastructure as we mentioned to align more closely with that. You need a different coating activity if you're focused on -- as your focus changes to more of a powder-based strategy, so there will be alignment, obviously, with the new revenue mix.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

Is the powder-to-coat technology or process available across all of your catalyst systems including the new Spinel catalyst?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

Yes, definitely.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

You mentioned that we had $1.7 million in the DuraFit business in the third quarter. Is that the first revenue, or was there any in the second quarter?

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

No, there's been revenue throughout. It's a significant increase consistent with the ramp we are seeing in the third quarter versus the second quarter.

David Shea - *Clean Diesel Technologies, Inc. - CFO*

Yes, second quarter was $1 million, third quarter was $1.7 million.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

Okay, so we're looking basically for $3 million to $3.5 million from DuraFit in the fourth quarter?

David Shea - *Clean Diesel Technologies, Inc. - CFO*

The first quarter was $1 million. The second quarter was $1 million. The third quarter was $1.7 million, so we're at $3.7 million through three quarters.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

Okay. The cost of doing business in India and in China, basically their margins are generally lower, their costs are generally lower. What are they currently using? And do you offer a cost advantage?

David Shea - *Clean Diesel Technologies, Inc. - CFO*

I think the automotive margins globally are very competitive, and I think India and China are no exception. But I think that plays to exactly what our strengths are.

Again, what we are offering among other things is the ability to reduce the cost of compliance by reducing the weight of PGMs in the overall cost of the catalyst. And that number is a significant portion of the bill of materials or the product cost, if you will -- the heavy duty market and as compliance and standards increase even in the light-duty space as well.

So, it's precisely for that reason that we see this opportunity and we are addressing it with the powder-to-coat strategy because that allows us to sell product or work with customers in India and China. We couldn't do that as a manufacturer of catalysts.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

Okay, so you will be shipping powder out of the United States? Or are you contracting with distributors that will do that for you?

David Shea - *Clean Diesel Technologies, Inc. - CFO*

The progression is likely to follow the path that you just indicated. It can be a combination of both. It will be based on the situation that we're looking at.

Ian Gilson - *Zacks Investment Research, Inc. - Analyst*

How will you price? Will you price that FOB California?

David Shea - *Clean Diesel Technologies, Inc. - CFO*

It will vary by customer, but primarily FOB California.

Operator

At this time, I'm showing no further questions. I would now like to turn the call back over to Matthew Beale for any closing remarks.

Matthew Beale - *Clean Diesel Technologies, Inc. - CEO*

Thank you very much everyone for joining us. We look forward to announcing and reporting on progress in the coming weeks and months and look forward to -- hope you will join us on the next call. Thank you very much.

Operator

Ladies and gentlemen, thank you for our participating in today's conference. This concludes the program. You may now disconnect. Everyone have a great day.
