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 Financial Officer, Clean Diesel Technologies, Inc.

Other Participants

Matt B. Koranda – Analyst, ROTH Capital Partners LLC
Ian T. Gilson – Analyst, Zacks Investment Research, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to Clean Diesel Technologies Third Quarter Financial Results Conference Call.

At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. [Operator Instructions] As a reminder, this conference call is being recorded.

I now would like to introduce your host for today's conference, Investor Relations Manager, Ms. Kristi Cushing. 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 the 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, in the comments made during the 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. I'll start with a summary of our third quarter, including some brief comments on each of our business segments and an update on some of our strategic objectives as well. Nikhil Mehta, CDTi's CFO, will then take you through more details of our third quarter financial performance.

I'm very pleased that our company is improving performance in 2013 and particularly in the progress we've achieved during the third quarter. The key factors driving our significant improvement in our bottom line performance this quarter were, first of all, stronger revenue, exceptional gross profit margin improvement and our relentless focus on operational improvement and reducing our cost structure overall. Profitability, growing the business and delivering value for our shareholders remain our top priority.

Positives for the quarter include the following: our strong operating performance and product mix helped to drive impressive gross profit margin expansion from 26.9% to 30.1%; secondly, a disciplined and thoughtful cost control effort enabled us to substantially reduce operating costs, having achieved a 17% reduction year-over-year; and third, for the third consecutive quarter, we've significantly narrowed our net loss from a year ago, which is a very encouraging trend; and fourth, we've reported solid revenue growth from our Catalyst division, which reflects the continued strength in our sales to our major OEM customer, Honda Motor Company.

In our Heavy Duty Diesel Systems division, we benefited from a substantial increase in sales in the California retrofit market. This improved performance helped to offset a slower retrofit activity in the other 49 states and the reduced sales in our mining and material handling customers, primarily in Europe.

And finally, we've continued to expand our IP portfolio, with patent filings now totaling 39 year-to-date.

We're pleased with the progress we're making and we know that there is more work to be done. Perhaps, our greatest focus today is in the area of sales, where we are doing everything possible with our distributors and suppliers to meet or exceed the expectations of our customers. Revenues of $14.2 million, a decline of just 1.4% year-over-year.

The Catalyst division external sales increased 9% versus last year. However, underlying growth was actually 39%, with continued strong sales to Honda.

Revenue in our Heavy Duty Diesel Systems division was down approximately 8% this quarter. And while we are disappointed, we continue to be pleased with the pickup in our California retrofit sales.

Looking to the remainder of this year 2013, we believe that market activity in California has increased based on, finally, a stricter enforcement policy and the approaching deadline for compliance by the end of the year. And this is coming primarily from feedback from our distributors and directly with certain key accounts in the state.

One of our primary areas of focus this year has been on operational improvement and reducing our cost base. We've made very good progress on these commitments during the third quarter and throughout the first nine months of 2013 overall. Although revenues were slightly lower, we were able to reduce total operating expenses by more than 17% in Q3 of this year compared to the same period last year. We believe that the reduction in our operating costs and the streamlining of the organization overall are sustainable and can be done prudently so as not to compromise our ability to support our sales growth and our investments in our technology going forward.

Looking at our bottom line performance, while we have more work to do, we were pleased to report a substantial reduction in both our net loss both for the quarter and for the nine-month period ending September. We're doing all that we can in the areas where we can control costs 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, and new distributors that we put on during the course of this year, we are now in a position to continue to grow our revenues going forward.

As we mentioned in our last conference call, we concluded a strategic review of our business which yielded two key findings: our need to continue to focus and accelerate our technology development; and to ensure that we have an appropriate business plan and structure in place.

As a result, we embarked upon an acceleration of our technology road map, focusing on expanding our product portfolio. And as I said, that has yielded 39 patents year-to-date, and particularly patents related to our zero-platinum group metal developments which we also referred to as zero-PGM or ZPGM technology.

Our goal with this activity is two-fold. First, we believe first-mover advantage will be critical to the commercial development of this technology, and we want to be in a commanding position in ZPGM 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 for applications in other verticals in the future.

As we continue to advance our technology, we expect to be in a position that potentially reduce or possibly even eliminate PGM costs from emission control products and offer compelling opportunity to a wide variety of customers in the industry segments.

So now, let's move on to a review of our divisions' performance for the quarter. We'll start with the Catalyst division. And as I said earlier, we're pleased to achieve nearly a 39% increase in sales after excluding for the impact of the reimbursement of the rare earth price increases and the $1 million revenue recognized last year relating to the completion of a contract to provide service support to CDTi's partner, TKK, for the establishment of its operations in China.

We also benefited from an improvement in gross margins and believe going forward that 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 third consecutive quarter.

Our success as a long-standing supplier of catalyst to Honda has been the primary contributor to this growth. We're optimistic that we can achieve improved results going forward for the business given the success of the new 2013 model of the Accord, which according to data published by Honda Motor Company themselves, the sales of the Accord have increased by more than 11% as of the end of October 2013 compared to the same time last year.

Our Heavy Duty Diesel Systems division did experience soft conditions across most of our end markets, both in the United States as well as in Europe. Our mining OEM customers continue to experience reduced demand due to a global slowdown in certain commodity sectors and we don't expect to see a change in this outlook over the near term.

The exception to this was our increased sales activity related to the California retrofit program, which was up over 88% this quarter as compared to the prior-year quarter and up over 13% sequentially. The increased activity in both funded and mandated retrofit activity in California is encouraging. And based on our most recent information that we have, we continue to see an increase in quoting activity and purchase orders.

Expanding our Heavy Duty Diesel Systems division sales from non-retrofit sources also continues to be an area of focus for us as it represents a more sustainable OEM and aftermarket business for the reduction of exhaust emission. For the third quarter, non-retrofit sales represented approximately 40% of our total Heavy Duty Diesel sales compared with 38% in the third quarter of 2012.

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

We're also pleased to report that cash used in operations was only $80,000 in Q3 of 2013.

I'd now like to comment on this morning's announced agreement with Pirelli to voluntarily dissolve our joint venture known as Eco Emission Enterprise, which began operations in April of this year. We originally established this joint venture to market and sell emission control products as well as Pirelli substrates for both gasoline and diesel applications in Europe and the CIS countries.

The decision by Pirelli and CDTi to dissolve the joint venture was really driven by the slower-than-anticipated progress in achieving the sales objectives that were initially established. As all of you can understand, the European market has been very slow this year overall and we definitely experienced some of that slowdown in the business results.

While this is disappointing, based on the progress achieved we did not believe it would be prudent to continue to make the investments in resources to support this venture. We appreciate the efforts put forth by the CDTi team, Pirelli and the E CUBE teams in this effort.

The dissolution of E CUBE is expected to be completed during the fourth quarter, and CDTi will simultaneously resume its operations in Europe as conducted prior to the joint venture. Pirelli remains a valued supplier to CDTi and we look forward to our continued relationship.

Looking forward to the 2013 fourth quarter and beyond, we expect to continue building momentum and anticipate growth ahead. With another quarter of solid operating improvement behind us, I remain confident that the management team and our employees are focused on the right areas. We're taking the strategic actions needed to capture opportunities within our core markets, operations and cost structure.

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

Nikhil Atul Mehta, Chief Financial Officer

Thank you, Craig and good morning, everyone. Following Craig's operational overview of the third quarter and business outlook, let me discuss in a little more detail our financial results.

Revenue of $14.2 million was down by a modest 1.4% compared to last year. Gross margin was 30.1% compared to 26.9% in the prior-year period, up 320 basis points. Gross margin also improved sequentially from the second quarter of this year and was within our expectations.

We anticipate that gross margin remains stable at current levels during the next quarter as total sales stabilized.

We reported a profit from operations of about $127,000 compared to a loss of $1.2 million last year. Loss per diluted share was $0.12 versus $0.24 last year.

Business division highlights for the quarter include the following. Our underlying Catalyst division OEM sales were up over 39% compared to last year as Honda Accord sales continue to be robust. The reported sales are up 9%. Included in this quarter's revenues is approximately $50,000 reimbursement for rare earth prices compared to over $250,000 last year.

In addition, as Craig mentioned, last year we recorded $1 million of revenue from our support services contract to our Japanese partner, TKK, which did not repeat year.

Reported gross margin was up 50 basis points in 2013 to over 24% this year. After adjusting for the TKK-related revenue in 2012, gross margin for this business improved by over 9 percentage points due to the reduction in the rare earth pricing just discussed, improved product mix, as well as continued improvement in manufacturing efficiencies, somewhat offset by a reduction in year-over-year intercompany sales.

Given the seasonality in automobile sales, while Catalyst sales remained relatively strong, we expect that there will be a decline in the fourth quarter sales compared to the third quarter as sales for the year peaked in the third quarter to prepare for the fourth quarter buying period – holiday buying period.

Our Heavy Duty Diesel Systems division sales of $8 million were down over 8% from $8.7 million last year. Sales increased by over 88% in the California retrofit program and approximately 80% in our North American OEM business. However, sales were down in North American retrofit activities in the 49 states excluding California. In 2012, we had significant sales in the New Jersey retrofit program and in the Texas school bus retrofit project.

In addition, sales were down in our mining and material handling business in Europe and in our exhaust and accessories business in North America.

We recorded approximately $3.2 million of sales under the California retrofit program. We expect that the momentum in California will result in a sequentially stronger fourth quarter in the Heavy Duty Diesel Systems business compared to the third quarter.

Gross margin in the Heavy Duty Diesel Systems business increased approximately 5.7 percentage points year-over-year to 31.4%. This margin improvement was a result of a richer product mix as well as due to higher content of CDTi-manufactured low-PGM catalysts in our Heavy Duty Diesel Systems' products.

Total operating expenses were down $900,000 or 17.4% from $5.1 million a year ago to $4.2 million. The reductions resulted from several restructuring actions implemented in the second half of 2012, partially offset by increased spending on patent filings.

Operating cash usage in the quarter was approximately $80,000, and we had $4.6 million of cash at the end of the third quarter.

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 comments on our financial results and operations. Back to you, Craig.

Robert Craig Breese, President, Chief Executive Officer & Director

Thanks, Nikhil. So in conclusion, I think as we walk through these quarter three results, you can understand that there is now a trend line that's been firmly established at CDTi in terms of operational excellence and continuous improvement in the areas of cost control and better management of inventories and cash.

At the same time, we continue to focus and drive hard on those opportunities that are near term and can generate additional revenue, and the California retrofit is a great example of a market which, as we all know, has blossomed extremely late given our expectations. But we're now seeing some serious revenue growth in California and we continue to remain very focused on obtaining every potential order that we can in that area.

What's very encouraging, of course, is the Honda story. Honda has performed very well as an automotive manufacturer and seller of vehicles, and we're very fortunate to be on some of its most important products including the Honda Accord which has performed so well in the market.

So I think in summary, this is a year of transition for CDTi. We continue to make progress in a number of areas. We continue to have opportunities that we need to work hard on. But at the end of the day, we look forward to our continued progress as we now move into the conclusion of 2013 and beyond.

So operator, at this point, this would conclude our formal comments and we'd be happy to take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question comes from Matt Koranda for ROTH Capital. Your line is now open.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Good morning, Craig and Nikhil. Thanks for taking my questions.

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

<Q – Matt Koranda – ROTH Capital Partners LLC>: I just wanted to start out with the Pirelli JV announcement, just a little bit more color on that. So, why do you think the sales targets weren't reached? Was it more a function of general market weakness in Europe or was it just not enough resources being devoted to sales, could you dissect this just a bit more for us?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes. I mean, so what was really challenging for all of us, Matt, as we entered into the joint venture was we knew that the European market was weakening. And in fact, that was part of the motivation on us wanting to try to work together with Pirelli in the joint venture, is we felt that we could get more leverage combining, particularly, SG&A assets, if you will, sales and marketing assets and combining them together.

And I would say that in terms of identifying opportunities, that worked for us. But unfortunately, what happens is, in a recession, which Europe is clearly in and has been for some time now, buying decisions either get postponed or pushed out in a situation where people are in a declining situation.

Example of that is in the mining industry. We have some mining customers that are down over 40% year-over-year and, in fact, are pushing out new platform developments as a result of that. So where we had expected to see some leverage and some efficiencies coming from the market, in fact it was just the opposite. And it really wasn't something that anybody in the organization, and I'm speaking Pirelli as well as ourselves, could have necessarily foreseen nor have corrected. It was pretty much a market-induced situation.

So I would say to your question that the primary reason that the joint venture was really not able to take off and fly was really market-driven, market results based on a very, very weak economy overall in Europe.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Okay, that's helpful. Thanks, Craig. Another one here on material science strategy. You guys have pursued sort of the material science platform, partnering with OEMs or large manufacturers for the last – basically about five months now. Can you give us a sense for how meetings have gone recently? And are there any quantifiable metrics you could share with us in terms of the number of OEMs you've met with, the number of repeat meetings, maybe there's some qualitative stuff you could share as well in terms of how far in negotiations you may have gotten with partners? And then, maybe what are some of the sticking points that you've hit with potential partners at this point in time?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Right. So, a pretty broad question and I'll try to be as specific as I can. First of all, remember, we're at the beginning of this journey in terms of developing what I'd call a disruptive or a breakthrough technology. And as a result, we're being very specific on the people we talk to and making sure that we have a protected landscape when it comes to patents and IP landscape. So what I would say to you, Matt, is that, we've been cautious in who we talk to about the technology because we don't want to over-promise and under-deliver.

And what I mean to say by that is, we don't want to get the cart ahead of the horse. We don't want to say we're capable of this and therefore let's get started on an actual business opportunity when there's still a lot of technology in development and a lot of patents and IP that we need to make sure is in place before we share or partner with any specific OE or other company.

Now, the technology roadmap, to some degree, governs who we speak with and who we can work with maybe in the more near term versus the longer term. As you probably recall from past discussions, the technology roadmap has many pieces to it. We're not just focused on gasoline engines for automobiles, all right? There are many different applications. I'll give you an example. Motorcycles would be one, stationary engines would be another. And so, there are some types of applications that lend themselves to, I'll say, a quicker adoption and benefit to the customer than others.

And so, we're being very, I would say, rifle shot in our approach as opposed to shotgun, in terms of whom we speak to and how we develop those discussions. But in grosso modo, I would say we've now spoken to about 10 companies. I don't really want to give you the names at this point just because I think that's confidential and pretty much a competitive piece of information. But these are about 10 companies in different types of applications, and I think the initial pick up from these folks that we've talked to has been quite positive. And so, we're at different stages of developing, in some cases samples, in some cases test protocols, in some cases actual production potential that we could work with these guys on. But I want to say that it's a work-in-progress. It's not something that we're going to flip the switch on overnight and all of a sudden see it go from zero to 100. It's more a process over time.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Okay, very fair. That's great color, thank you. So in terms of gross margins, can you talk about the gross margin trend with the shift in the strategy? And if and when you begin generating the licensing revenues or partnering with OEMs to provide the zero-PGM technology, how can we expect gross margins to trend maybe during 2014 and then sort of when you hit the run rate in the long term with that eventual vision where the gross margins eventually get to?

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Hey, Matt, thanks for that question. Again, it's a very broad question. As Craig said, this is something that's going to evolve over time. We are developing various business models for the kind of material science company that this could be, and those models range all the way from joint ventures to licensing to maybe even selling the secret sauce. We don't know, okay? So it's just an area where we expect to derive a higher gross margin than what we do as a manufacturing company in the catalyst business because we think we can monetize and get more value for our technology through these different vehicles. And that's about all I can really say. And at this point, I won't speculate on what kind of impact this will have in 2014 or beyond, okay?

<Q – Matt Koranda – ROTH Capital Partners LLC>: Okay, that's fair. I have another one here for you, Nikhil, as well on working capital. You guys did a great job holding the line on working capital and cash flow from operations during the quarter. Can you discuss how you're managing working capital during this quarter to ensure that you can handle the increased order flow during the Q4 retrofit ramp?

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Yes. So – well, there's a couple of things that have been happening. We've been managing inventory very tightly, especially over the last couple of months, okay? The slow uptick in California had us a little bit out of whack with our inventories in the first half of the year. And so, we are seeing a bit of a benefit from that in the third quarter. I'm just being totally transparent here. So, we've built up a little bit of inventory that we actually laid off in the third quarter. So to answer your question, if the sales continue, the momentum in California if it continues in the fourth quarter, there could be a little more increase in working capital.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Okay, all right. And then, there's another one here on California, the market in HDD. Now that we're past Q3 and well into Q4, can you give us a sense for how the retrofit ramp is trending? I know you guys said it was up 88% year-over-year in Q3. What kind of information are you guys getting from distributors on Q4 and how much higher could it be versus Q3?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes. Matt, again, those are good questions. I mean in reality, the momentum is continuing in Q4, and I think we touched on that earlier in our remarks. I don't know that I would expect to see it changing really. I think that the thing that's interesting for us is lead times - that we're quoting for our systems as well as our competitors are quoting.

And what's happening is I think we're probably benefiting from the standpoint that some of our competitors are based in Europe and have longer supply chain lead times, okay, just by the fact that they're in Europe. And I think we're benefiting, to some degree, by that, all right? So, that's an additional plus that we really haven't counted on.

I think the other thing is that with the approval of our EGR system, and you may recall we talked about that earlier in the year, we are actually now seeing some EGR sales come into fruition, and that had been a very fairly slow seller for us up until this last quarter. But we have seen some traction in that regard. So that's, if you will, expanded coverage of our product portfolio, that is also helping us.

So, a combination of things. I would say, focus on our lead distributors and some of them have been picked up in the last year. They're doing a great job. Expansion and product portfolio. Very competitive lead times from us, I would say it like that. And really, our ability to kind of complete the cycle from data logging to quotation to shipping to installation on the units. All of that has gone pretty flawlessly. And our team both in Oxnard and Markham, Ontario have just done a tremendous job, I think, of keeping up with demand and, in fact, to some degree, getting ahead of it.

So, some very good execution on our part I think is helping to drive these results. So I'm optimistic that we are going to see some good opportunities here again in Q4. And as we always said, we thought this thing was back-loaded and it's turned out to be back-loaded.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Okay, thank you for that. And one last one here on enforcement. Craig, I know you mentioned enforcement briefly in your prepared remarks. But maybe, you could just get a little bit more specific in terms of what you guys are seeing, the latest efforts by CARB to enforce the rule and what you guys are just seeing in the market right now?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: Yes, I mean remember there's two aspects to enforcement. One is the physical enforcement on the grounds of issuing citations, things of that nature, right? And they've been a few fairly high profile cases where CARB has, in fact, fined some trucking companies hundreds of thousands of dollars. And those have been well circulated and well documented throughout the trade and has gained, I would say, a lot of notoriety, and that's exactly what CARB wanted to do.

At the same time, there's what I'll call the soft enforcement, which is really about the regs on the books saying, look, you have to have your orders in by a certain date in order to be "compliant" for 2013. So, that wasn't so much on the ground enforcement as it was regulatory enforcement, but that was on the books.

So what's been happening is dealers and installers have been reminding the truck owners and the fleets of their obligations, and that has – had a trickle-down effect, I think, in a lot of cases to influence the buying decisions of truckers and fleets to go ahead and – if not, get the installations done. At least get the orders in the system, so that they can be considered to be compliant under the CARB regulations. And so, I think those two factors together really have contributed to some degree to the stronger – the strengthening of business climate that we're seeing in the retrofit project here.

<Q – Matt Koranda – ROTH Capital Partners LLC>: Great, very interesting. Thanks, that's it for me guys.

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

Operator: Thank you. [Operator Instructions] And our next question comes from Ian Gilson with Zacks Investment. Your line is now open.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: Yes, good morning, gentlemen.

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

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Hi, Ian.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: A question on Pirelli agreement. You lost $800,000 year-to-date on that?

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: The joint venture lost $800,000, Ian. Our share of that was 50%.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: Yes, okay. Now, can you look at that from the point of view if you have not had the agreement, what would be the profit or loss on that business have been? Was it all new business or was it business that in fact had been established before the JV was established?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: I mean there were operating costs, Ian, that we would have acquired, if you will, as a standalone company. I don't know, Nikhil, that we've actually run those specific numbers at this point.

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Yes. My guess is, Ian, that just conceptually, if we have not have the joint venture, our revenues in Europe would have been a little higher because we paid a commission to the joint venture.

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

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: But our costs should have been a little higher because we actually moved people into the joint venture. So overall, I haven't done the full math yet. This is just literally a late breaking news and I would suspect that we were close to breakeven.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: I would say to you, Ian, there were a couple of people that left the organization during the joint venture, that had we, let's say, dismissed them, which we most likely we've done, had we stayed as a standalone, the severance costs for those people would have been very significant and I would say would have probably canceled out any net benefits that we would have had. So in reality, whether we were in the joint venture or we weren't, I don't know that there's a big difference in the net effect to CDTi during the seven or eight months that we're talking about here.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: Okay, okay. Now, on the California compliance. What happens if and when almost the existing truck market becomes compliant?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: All right. So let's, yes, let's go into kind of a futuristic – and I'm not going to give you any predictions here – but let's talk about the California project okay. So as you know, if you were a big fleet owner, and most of the market in California was the larger fleets, what you most likely did was you signed up for a three-year program with CARB whereby you said year one, which was 2012, for all intents and purposes, I would get about a third of my fleet compliant, okay? And then, CARB gave you a dispensation and they said, okay.

And then, year two, being 2013, I would get my second, third of my fleet compliant. And then, your three, 2014 in this discussion, I would finish up my fleet compliance, so all right. And there are many, many fleets across the state that are exactly in that situation, they're following that schedule. So we will expect to see, as will the market, additional compliance conversion units in 2014, all right?

At the same time, a large part of the California market is made up by owner operators or very small owners of trucks, okay? And that is a more difficult market to asses because, in a lot of cases, they either trade out their trucks, they'll wait till the last minute – let me give you an example. They'll wait till the last minute to become compliant. And at that point, they'll do a calculation and they'll say, am I better off buying a new truck and selling my old truck, and that probably goes out of state at that point, what's my best decision. But what they've tried to do, the owner-operator, is push out compliance as long as possible.

So, I think what you'll probably see on a macro level next year is they will come to change concession for those little guys. So, the guys that aren't compliant, and frankly haven't been caught yet by CARB, will have to make a decision: they'll either sell their truck, or they'll become in compliant, or in some cases in the California truckers association talks about this, they'll actually close up shop and go out of business. And they're actually thousands of little owner operators across California, they're doing exactly that. So it's really hard to asses, it's really hard to predict, but there will be additional business next year for sure as this compliance starts to wind down in 2014.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: So if you look at it, you've got a part of the market from 2012 has drifted through 2013 into 2014?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: That's probably a fair statement.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: And that after 2014, basically, the requirements remained constant? And then, by then, the retrofit market, to bring those down to a very low number?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: That's probably pretty accurate. It's hard to put numbers around it, but the trend that you're describing I think we all agree with.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: Terrific. Okay, okay. Now, one of the sort of concepts and part of the Pirelli agreement, they would take over some of the metal bending side of the business and some of the catalyst substrate would come out off the JV. Now presumably, you will go back into that sort of basic metal bending and still buy catalyst substrates from them?

<A – Craig Breese – Clean Diesel Technologies, Inc.>: All right. Yes, maybe there's -- it's probably a little confusing because there's lot of pieces to these discussions. But the actual agreement that we entered into with Pirelli was strictly a commercial agreement, all right, which really had absolutely nothing to do with manufacturing, okay?

So, just think of it this way. We were supplying systems to certain customers in Europe. And on the Pirelli side, they were supplying substrates to certain customers in Europe, all right? And the group, if you will, was consolidating those sales of those two product categories and then sharing in any benefits that resulted from those sales. But there was no metal bending going on in the joint venture per se, all right, just to be clear. What Pirelli continued to do separately was supply some retrofit systems to certain customers in Europe that was outside of the joint venture though. That was strictly Pirelli doing their thing. They never wanted to bring the retrofit inside the joint venture and candidly they pretty well wind that business down.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: Okay, fine. Thank you very much.

<A – Craig Breese – Clean Diesel Technologies, Inc.>: You're welcome.

Operator: Thank you. [Operator Instructions] And our next question comes from Karthik Srinivasan. Your line is now open.

<Q>: Yes, it's Karthik Srinivasan. I had a couple questions. I guess my first question just pertains to the gross margins, and you talked briefly about this, at least with respect to the HDD business. But there's obviously a pretty big sequential ramp in terms of gross margins, and by my calculations your incremental gross margins were over 60%. I'm just curious if you delve in a little bit more into the sources of that gross margins improvement. And to the extent we do expect improvements in the HDD business in Q4 given the car brand, if you can give some guidance as far as what gross margins could be in Q4?

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Hi, Karthik. Yes, well, I did say in my remarks that overall as a company, I'm expecting gross margins to be consistent with the third quarter. There's a couple of things going on inside which I also mentioned. In HDD, we're certainly selling higher-margin products now than we've ever sold. Some of the larger filter, especially in California, have higher margins than some of the other products that we sell across the 49 states.

So that trend is going to continue, at least through the fourth quarter, because we know that we are seeing a really good California activity.

On the Catalyst side, our margins have improved primarily – again, two reasons. We are selling slightly more profitable product now to Honda than we used to. It's a combination of getting a broader range of Accord, like we have some of the 6-cylinder, we have the Hybrids, et cetera. But also, our catalyst plant is operating at a very high level of efficiency right now. They've done a great job. So, I expect that to continue too.

But like I also said, because of the holiday buying season, third quarter is usually the biggest sale month for the suppliers to auto companies, and I would expect the Catalyst sales to be somewhat down sequentially. So, that might have a negative impact on overall margins. But overall, California is doing good, Honda revenue may be coming down a little bit sequentially, I expect the margins to be roughly the same. That's what I said in my remarks.

<Q>: Okay. And as far as Honda is concerned, can you give an update as far as new business development with that customer? And we've obviously been expecting some additional models. We've got a couple of small in terms of unit volume, additional deals with the Accord, but there hasn't been really any update, at least publicly as far as that's concerned?

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Yes, we haven't really given any updates. So we did – we are manufacturing more parts for Honda now than we've ever done in the past. I mean we have more models of the Accord than we've had in the past. We used to have only the 4-cylinder. Now, we have some of the 6-cylinder. We have the two Hybrid models, and actually they're doing pretty well I believe.

And also, we did have the Acura TSX and we are working on the future models to go along with that. If and when things happen, we will certainly be announcing.

<Q>: Okay.

Operator: Thank you. And we have a follow-up question form Ian Gilson. Your line is now open.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: I'm a little conflicted here on California. You did what? $3 million in the third quarter?

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Yes, about $3.2 million, yes.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: And I have a note here that it should be half in the fourth quarter. Am I incorrect in that assumption?

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Yes. We're saying sequentially, we're expecting California to grow.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: In the fourth quarter?

<A – Nikhil Mehta – Clean Diesel Technologies, Inc.>: Yes, sequentially.

<Q – Ian Gilson – Zacks Investment Research, Inc.>: Okay, fine. Thank you.

Operator: Okay. At this time, I'm not showing any further questions. I would like to turn the call over to Mr. Breese for any further remarks.

Robert Craig Breese, President, Chief Executive Officer & Director

So again, thank you for your interest in Clean Diesel Technologies and our continuing progress in the business. And we'll look forward to our next communications.

Operator: Ladies and gentlemen, this does conclude today's conference. Thank you for participating. You may all disconnect. Everyone have a great day.