

endeavors. I would also like to welcome Claus Toftegaard as our new Chief Financial Officer. Claus joins us with many years of experience and most recently as the CFO of Gabriel Holding, a publicly traded fabric supply company in Denmark. I look forward to working with Mark and Claus as we face the many exciting prospects for LiqTech.

To wrap things up, we believe that we have the right products, the proper operating structure, the balance sheet, the market tailwinds to drive strong growth in 2018 and beyond. And we also believe that we have the visibility to turn the company profitable. We thank our shareholders for the support over the years and look forward to repaying that support in the years to come.

With that said, let me now turn the company over to any questions there might be. Thank you.

QUESTIONS AND ANSWERS

Operator

We will now begin the question-and-answer session. To ask a question you may press star (*), then one (1) on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*), then two (2). At this time we will pause momentarily to assemble our roster.

The first question today will come from Eric Stine with Craig Hallum. Please go ahead.

Eric Stine

Hi Sune.

Sune Mathiesen

Hi Eric.

Eric Stine

Maybe we could just start with the Mark 6. You mentioned that it will enable you to manufacture more efficiently, and I also know that you've outsourced a lot of the non-core manufacturing. So, maybe just, one, maybe an update on what that might mean for your annual capacity? And then I'd also love to hear, you know, beyond what it means for you what this new product means for the main applications that it will be for, marine scrubber and power plant?

Sune Mathiesen

Yes. As you correctly say, we have been outsourcing a large part of our manufacturing process over the last six-to-nine months. We obviously still have the manufacturing of the silicon carbide membranes in house. That's the heart of our systems and this is our unique technology. But, we have outsourced welding of pipes, welding of skids, assembly of the systems, and so forth. That has been an ongoing process for some time now, and it has been a successful process, which enables us to ramp up capacity much more efficiently than we would have been able to do with in-house manufacturing. And that's very important going forward. We see very positive development right now in the marine scrubber industry. We see a very rapid development, and I think it was absolutely the right choice for us to outsource a large part of the manufacturing and it will allow us to ramp-up to follow the general ramp-up in the industry.

As to the Mark 6 system, this is a very important step for us. We have been working on that system for a while now. It is a more versatile system than we had before. It means that we can use it for a lot of different applications, predominantly for scrub applications and of course marine scrub applications but also in power plants, but it will also be used for several other applications. It is truly a standardized system, which has been important for us as well. It allows us to have much shorter lead times and more importantly, we have been able to cut costs of about 30% to 35%, which obviously will improve our gross margins.

Eric Stine

Absolutely. So I'm interested in the commentary that you had about substantial orders expected in 2018, and obviously in 2019. Just curious, is there any way that you can provide some color or more specifics around that, whether your two framework customers have started to receive orders and that's what's giving you the confidence? Or maybe just visibility into that statement.

Sune Mathiesen

Yes, I think that our confidence comes from several things. One, yes, we have these two framework agreements. We have seen these customers starting to receive orders, and that gives us confidence that we'll actually see the amount of business coming out of the framework agreements that we anticipated. But as I also mentioned, we are continuing to form partnerships with ship owners, with shipyard operators, scrubber manufacturers, and in general, we see that this market is developing very rapidly. I think there's a general perception that the uptake in scrubbers will actually be higher than first anticipated and to support that we have seen a lot of announcements from scrubber manufacturers over the past one or two months that they have been filling their order books for 2018 and 2019, even 2020, which is a very, very positive sign for LiqTech as well. We are currently in discussions for orders for a very, very high two-digit number. So I think we have a lot of confidence that this is actually developing the way we thought it would. I would even say that it's developing more positively than we thought it would, and the long-term relationships and the agreements that we have in place with ship owners, shipyards, scrubber manufacturers gives us visibility now to say that we will see this growth. We will turn the company profitable in 2018, and we will see the growth for 2019 that we always anticipated.

Eric Stine

Right. And so some of the order activity or confidence that you have is outside of these framework agreements? I mean, these are people that you don't have anything official right now but I would assume, it sounds like you do anticipate that you will at some point?

Sune Mathiesen

Yes, we are continuing to widen our customer base in this industry. As I mentioned, we are working directly with ship owners. We are working directly with shipyard operators, and we are working with a larger and larger number of scrubber manufacturers. We have these two framework agreements in place. We have the letter of intent announced earlier with one of the world's largest scrubber manufacturers in place. And besides that we have a handful of established relationships with scrubber manufacturers, and all of this combined leads us to believe that we will see the growth that we have been talking about.



Eric Stine

Got it. Okay. Maybe just lastly for me, just on the topic of the letter of intent with that prospective customer, I know that you had been targeting systems, or system integration and also that that company was trying to put together their go-to-market strategy. Maybe just talk about your understanding of where that company stands in the process of both of those two?

Sune Mathiesen

Yes. That relationship is progressing according to plan. We were very happy to announce the extension of the letter of intent. We are working diligently to complete the process with both companies. All the basic stuff is already cleared. We have tested our technology very successfully and now it's more a matter of taking the new product to market, and all of this is progressing according to plan.

Eric Stine

Okay. Thanks a lot.

Sune Mathiesen

Thanks, Eric.

Operator

Again, if you would like to ask a question, please press star (*), then one (1).

The next question comes from Morgan Frank with Manchester Management. Please go ahead.

Morgan Frank

Hi Sune, good quarter. I had a quick question for you on contribution margins and how to think about gross margin going forward. It looks like incremental revenue dropped to the gross profit line at about 55% from last quarter, but if we compare it to Q4, it actually looks like it was something like 100% contribution margin. So, I'm guessing that that's probably too high to use going forward. Can you give us some sense of what the next couple of million incremental revenue would look like on the gross profit line?

Sune Mathiesen

Yes, we can do that. Good morning, Morgan. Well, with the new Mark 6 system, we will see higher contribution margins moving forward. We actually think that we will be able to realize contribution margins of around 70% to 75%. Of course, not all of that will drop down, but a significant part of it will. As we increase volume, more and more of that will drop down to the bottom line, and this is probably going to be in the region of 55%, 60%.

Morgan Frank

Got it. And so, as I look at your cost of goods sold now, what would be a good number to use just as an estimate of fixed costs? If you didn't...

Sune Mathiesen

Yes. The level where we are right now is a good level for future estimates. We have made significant investments in our organization, which means that there will not be a lot of investments going forward. We have prepared for this ramp-up of the business that we are experiencing and we have also prepared for future ramp-up of business, so we are not looking to significantly increase our costs.



Morgan Frank

Okay. And so, we'll start to see the actual unit margins on the systems drop through pretty fully?

Sune Mathiesen

Yes, as we progress, as we see volumes increase, we will see that drop-down escalate.

Morgan Frank

Okay, great. That takes care of me. Thanks very much.

Sune Mathiesen

Okay. Thanks.

Operator

Once again, if you would like to ask a question please press star (*), then one (1).

The next question will be from Bill Chapman, a private investor. Please go ahead.

Bill Chapman

Yes, good afternoon. On your scrubber manufacturing partnerships that we're hoping to have three once this third one closes, do you anticipate more formal contracts with other scrubber firms, or is it going to be more case-by-case orders in a less formal arena?

Sune Mathiesen

Yes, that's a good question, and it's actually going to be both, so some of the larger scrubber manufacturers you will probably see a few more framework agreements just laying out, let's say, how we are working together. But we will also see case-to-case orders. We see a slight change in the way this market is working right now. We see that, you can tell it's a new industry, thought its already becoming a commodity and we believe that we'll see a lot of the orders in the future come directly from the shipyard operators. It doesn't necessarily mean that, or it doesn't mean that we will not see orders coming from scrubber manufacturers; it just means that there will be several sources for orders in the future.

Bill Chapman

Okay. Thank you. Going forward, do you anticipate being able to announce an order flow, or is it going to be on a quarter-to-quarter basis when we see the actual recognized revenues?

Sune Mathiesen

Yes, as we see this market firm up, we will see less announcements probably, for competitive reasons. We are not that keen on making announcements all the time. There is a, this industry is becoming very attractive for a lot of players, and what we want to avoid is to announce smaller amounts of orders. We will of course announce any very large orders, but more and more, we will update the market on a quarterly basis.

Bill Chapman

Okay. Let me ask you also, on the financing, I saw Goldman Sachs and some Wall Street firms getting involved offering financing. Is that really picking up quite a bit?

Sune Mathiesen

Yes, we have seen Goldman Sachs, for example, being out there offering to finance scrubber installations. We even see shipyard operators financing this for the ship owners. So, we think there are a lot of financing opportunities available for ship owners, which obviously supports the business gains for scrubbers even more, which is good news for LiqTech.

Bill Chapman

Okay. One last question, if I could, please? As you know, there's quite a bit of discussion in the trade magazines about what's going on with this 2020 mandate. And I just saw one last week that commented that according to industry sources, at least 60% of the current ships are expected to opt in for scrubbers by 2022. Now, I've never seen a number that high. I've seen up to 20%. Is this an outlier, or is this just really a mass wave of interest in converting to scrubbers in a material way than what we've seen?

Sune Mathiesen

What we have been working with is the 20% uptake of scrubbers by 2025. What we have seen recently is that it looks like there will be an even higher uptake in scrubbers. Trying to be conservative, we think the 20% number is a good number. That is a huge opportunity for LiqTech. It is a \$6 billion addressable market for us over the next seven years. Of course, we would love to see a higher uptake than that, but we think even with the 20% number, it's a great opportunity for us. But, as you rightfully say, it looks like the adoption of scrubbers will be heating up.

Bill Chapman

Okay. Thank you very much.

Sune Mathiesen

Thank you.

Operator

Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

CONCLUSION**Sune Mathiesen**

Thank you very much, and thank you to everyone for joining us today on the call. We look forward to speaking with you again very soon. Have a great day.

Operator

And thank you, sir. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

