The ExOne Company
Second Quarter 2014 Financial Results
August 14, 2014

Operator: Greetings, and welcome to The ExOne Company’s Second Quarter 2014 Financial Results Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Ms. Karen Howard, Investor Relations for ExOne. Thank you. You may begin.

Karen L. Howard: Thank you, Melissa, and good morning, everyone. We certainly appreciate your time today for our second quarter 2014 conference call.

On the call with me this morning are Kent Rockwell, Chairman and Chief Executive Officer; David Burns, President and Chief Operating Officer; and Brian Smith, Chief Financial Officer, of The ExOne Company. We will be reviewing the results for the quarter and first half year that were published in the press release distributed after yesterday’s market close. If you don’t have that release, it is available on our website at www.exone.com. The slides that will accompany our discussion today are posted there as well.

Referring to the slide deck, on slide two is the Safe Harbor statement. As you may be aware, we may make some forward-looking statements during this discussion as well as during the Q&A. These statements apply to future events and are subject to risks and uncertainties, as well as other factors that could cause actual results to differ materially from what was stated here today. These risks and uncertainties and other factors are provided in the earnings release, as well as with other documents filed by the Company with the Securities and Exchange Commission. Those documents can be found at the Company’s website or at www.sec.gov.

We have Kent first provide a strategic overview, David will review our second quarter 2014 progress, revenue, and margin results, as well as our revenue look ahead for the second half of 2014, and then Brian will provide a detailed review of the financial results. Then, we’ll turn it back to Kent to discuss our outlook.

With that, I turn it over to you, Kent.

S. Kent Rockwell: Thank you, Karen. Good morning, everybody. Thank you for joining us for our call on Q2. We have a couple of slides that I’ll address briefly and then David and Brian can get into a lot of the detail, and I’ll close it up.

The first slide is to remind you that ExOne is a distinctly positioned company in what we have defined as a very disruptive technology — 3D printing for the industrial marketplace. Specifically, we are in the technology of binder jetting, which is a subset of 3D printing distinct from other technologies, such as some of the laser and e-beam technologies. We believe that binder jetting is a unique technology that is applicable in some instances to materials that cannot be printed using laser-type technologies. We further believe that binder jetting will be a more cost-effective approach for batch and high volume production as we move into the future, and we’re getting more and more verifications of that as we move along.

We are developing materials that are a vast array of metals and other carbon and graphite-type materials, and we are accelerating development in certain areas as we move through this year. Our business, I’m pleased to remind you, is two-thirds international and one-third the U.S. market. For a small, but high growth company to be operating on a global basis with major offices around the world is a real challenge as we start to grow, and so we’ve got a fairly high level of SG&A relative to our current revenues, but that’s all in line with where we believe revenues should go as we move into the later years here.

Moving to the next slide, I want to highlight that this is a transition year for us for a variety of reasons, and I’ll try and cover some of that quickly. First, I think everybody here should recognize that the 3D industrial
printing sector is certainly growing very rapidly. You can find this being verified all across the marketplace, including inside many of the publications that you may read. There is certainly good evidence that the industrial demand is now starting to accelerate as some of the applications are maturing.

The size of that industrial opportunity on a global basis is certainly well into the billions of dollars. We firmly believe that the opportunity remains for us to move, over a series of years, into the $200 million, $300 million, and $400 million dollar market sector as we continue to successfully penetrate the market with our technology.

Again, it's a high growth environment. When you are managing high growth, you have to recognize that there is constant change management taking place. Any time volume doubles, you have to look at every process that you are currently using and question whether or not that process is an effective management process for the future. We are currently embedding several processes for the future which are very substantial, such as the XRP, and Brian and David will tell you about some of the other processes we are implementing this year.

We've made substantial capital investments in proprietary technologies. David is going to talk a little bit more on that, but we have a whole bunch of new patents that are being applied for right now, that will be done fairly soon. They are very, very strong patents with regards to new material applications that we've been working on for some time and they are quite exciting.

Remember that in an environment like ours, with high growth and all this proprietary change, you are in a constant state of evolution. You are going to go back every six months and look at your strategies and expand them, narrow them, and then readdress them in every regard. We are constantly looking at new opportunities and shifting some of these strategies as we move along.

In any high-tech investment area, you are going to naturally make some mistakes as you go along that path. You must grab those mistakes and fix them. We have one mistake in this quarter which David will address, but it's not upsetting to me because we caught it, we fixed it, and we learned from it; we implemented a solution. However, it did hit our P&L more than we had anticipated in this past quarter.

We have an unpredictable order flow; it is sort of natural in this business right now. Timing is set by customer needs. I did go through the order book this morning. This is not backlog, but we have over 20 machines that are looking at the potential of being able to recognize the sales in Q3, and over 30 machines in Q4. Not all of those are going to happen, but we are confident about our ability to make delivery on those that do.

If we go back to the fourth quarter of this past year where we missed four machines, all four of those machines have now been delivered. We're not losing sales. We're simply seeing these sales move to the right for a variety of customer requirements. We only had eight opportunities in the fourth quarter of 2013 and four of them shifted out, but now we have over 50 as we look into Q3 and Q4 of this coming year.

I think we are moving through this transition year in good order and I believe that the opportunities are really starting to solidify. More importantly, a lot of the technology development that we are just finishing on the material side isn't being recognized in revenues yet; it is not being recognized in non-machine or machine sales yet, but it will impact us dramatically as we move into 2015, in addition to some large funded research opportunities with certain government applications. David will discuss those opportunities later.

With that, I am going to let David talk to the numbers and I'll be back at the end.
David J. Burns: Thank you, Kent. Good morning, everyone. As Kent said, we have understood all along that 2014 would be a transition year, a year of investment, learning, and development. I want to quickly cover investments in Q2 and then we'll move on to the result and financials.

On slide seven, I'd like to take a look at our build-out with people; as we continue to say, people are our most significant asset. We crested just above 250 people in the second quarter. If you look back at us pre-IPO where we were at about 158 people, of course that's significant growth. On top of that, if you think about the fact that some of those original 158 have turned over, it means that half of our people on board right now are new since Q1 of 2013. It is both a tremendous opportunity and a tremendous challenge to teach and train people to be ExOne folks. In addition to that, our hiring rate has leveled off significantly. Now that we've built out our sales force and R&D resources, and also some other areas we talked about before, you can expect that we are in a level period relative to people today.

Slide eight discusses our investment in creating greater control over our business planning and execution. We are in the process of rolling out a global quality system, ISO 9001. We're in the process of installing the first phase of our global business system, which we expect to go live here right up around year-end. These control systems are absolutely catalyst for us doing business in a fundamentally different way, with greater organizational effectiveness, and of course, we've hired a variety of talented people to support these roll-outs. You can see our internal symbol for our ERP system shown here, XRP, simple, common and global.

Moving to slide nine... We are building out the capacity necessary to sustain us for the coming years. You can see in this picture our new European headquarters near Augsburg, Germany. You may recall that we are combining five European locations into a single location, creating much greater efficiency and radically expanding the capacity we have available to us. This picture was taken a couple of weeks ago. The facility build-out is on schedule. We expect to begin occupying the offices in September and we expect to have our production moved over by mid-November, end of November. By year-end we will be fully occupying our new building.

Slide 10 continues the theme of capacity expansion. In the second quarter, we closed on the purchase of our Japanese headquarters, a building that we have been occupying since 2006. In Italy, we built out a new sales center. It's located in Northern Italy and it will definitely help us serve the Italian market to a greater degree than we have so far. In North Huntington, we broke ground on a nearly 10,000 square foot combination renovation and new build-out. We took this picture yesterday and we stuck it in here, so you can see a sense of what's happening here in North Huntington, near Pittsburgh. That will also be complete this year. By the end of this year, we will have significantly increased our capacity to serve our markets into 2015 and beyond.

I want to pause at slide 11 to talk a little bit about one of our major investments in the second quarter, and that was in the continued development of our ExCast initiative. You may recall that ExCast is a multi-step production process, where we take optimized product design and we combine that with 3D printing, and then we merge it into the traditional world of metal casting. In Q1, we talked about a major casting program that we received an order for and that we felt, during our last earnings call in May, this program had been substantially completed and that its impact on our margins had substantially been realized.

The program involved the design of more than 10 separate part numbers and of these, we manufactured more than five of each individual component, meaning that we needed to deliver more than 50 castings that were made from very advanced materials, and in shapes that quite honestly would have been deemed unmanufacturable a few years ago. At the time of our last earnings call, we completed the printing for nearly all of these parts and the casting process had also been completed for most of them. Therefore, we felt that we were substantially through the program.
Following that call, as the parts proceeded through to final machining, testing, and certification, we and the customer realized that the toughest of those parts were not going to qualify for aerospace certification. We’ve done several iterations of redesign and remanufacture of the toughest of those parts since, and all of that effort has resulted in the development of both new binders and new print media to try to address the issues that we saw in terms of casting those parts. This has been a very difficult process for us as a company. The lessons we’ve learned here have become a direct bridge to some very, very significant funded research opportunities that we see coming especially for defense and governmental agencies.

While we have suffered through this, we have learned a lot of lessons. Both we and the customer understand better some of the limitations of the material set that we were trying to cast. We feel we are much better prepared moving forward and we do think actually this is going to be a significant springboard to some larger opportunities going forward, so there has been major investment in Q2 in the ExCast side of the business.

Slide 12 talks about material development. You may have noted that during the quarter our investment in material development led to the announcement of commercializing a nickel-based 625 alloy that’s especially targeted for aerospace. We continue to prioritize all of our new material development efforts. As Kent mentioned, based on customer opportunities, we are now pursuing a group of materials that can only be 3D printed using binder jetting.

We are going to file significant IP related to those materials and we expect great commercial opportunities to result. All of these efforts that we are undertaking with material development are now giving us access to significant additional funded research projects, both governmental and non-governmental. All we can say at this point is they are multiples larger than anything that we have seen to-date.

Slide 13, on the machine development side of the business, Q2 saw an acceleration of machine development beyond our original plan. The clear opportunity to meet some customer requirements and customer opportunities caused us to accelerate our machine development efforts. Honestly looking at it, we feel that the acceleration affected all major cost categories, everything from R&D, to SG&A, to even machine margins and working capital. The fact is, that we are taking our Print platform that we have today that’s largely focused on casting applications and adapting it for direct printing. We are also developing right now a new S-Max version that allows us to use both phenolic and inorganic binders more effectively, and it required a significant design change to the S-Max machine.

Additionally, we are in the process of designing a replacement for our Lab platform, which you’ll be hearing about later this year and early next year. We’ve also launched significant efforts to produce our first high-volume, high-production machine for series production for industrial parts. That’s another project you’ll be hearing about towards year-end but, quite honestly, the aggregation of all of these efforts, are an acceleration of machine development. While in the short-term, it required some investment, in the long-term, we see clear opportunities to exploit those new machine designs.

Let’s jump to slide 14. Revenue for the second quarter was $11.2 million, and you can see that machine revenue was a bit above non-machine revenue. We think over time that will be about a 50-50 split, and we approximated that in the second quarter. We think the regional split will become nearly equal between our three regions of the world, and we came in pretty close to that in Q2.

On slide 15, you can see that non-machine revenue is a bit ahead of machine revenue for the first half of the year. We expected that, because machine revenue is largely skewed to the second half, traditionally, and this year that will be true again. You can see the split by region, and of course the Americas was the strongest business region for us in the first half of the year.

On slide 16, you can see the category of non-machine revenue. I should remind you that for us, non-machine revenue includes our sale of consumables that customers use for our machines, the output from our
production service centers, the parts that are sold, as well as service and service parts. We have very
determinedly tried to grow this side of the business, because it represents a somewhat recurring revenue
stream. It provides a great foundation upon which we can then execute a machine business which is a
little more volatile and cyclical. We have seen great growth in non-machine revenues over the past few
years, and we achieved $5.2 million for the quarter, and you can see the compound annual rates of
growth. We are very pleased with the build-out of our non-machine business.

Slide 17 provides a quick look at machine sales. We sold $6 million worth of machines in the second
quarter of this year and the detail of that was in our press release. As I said before, our machine sales are
skewed to the second half of the year. We're a bit more about that later.

Moving to slide 18. In a moment, Brian Smith, our CFO, is going to give a more thorough vetting of the
P&L and the balance sheet. Before that, I just want to pause here; as a management team, we are very
cognizant that our gross margins in Q2 were not in-line with some expectations. We believe, as we
entered the second quarter, that were going to see gross margins more in the high 30% than the low
20%. We probably were about 15 percentage points short of where we expected to be.

I explained before, about $1 million in cost is directly attributable to the build-out of ExCast, and that
ended up being about nine margin points. While it was a bit disappointing, and it was a struggle to get
through the experience, as I explained, we believe that we have now identified how we can turn that
experience into a positive for the company, but there was certainly an investment in the second quarter of
significant magnitude.

Also, when we began looking at our second quarter, we anticipated shipping one more S-Max machine.
The shipment of that machine likely would have changed our margins by two to three points. Based on
the mix of machine and non-machine, we probably lost about three points in margin for the quarter. Then
there are various other things that contributed, such as absorption and warranties, that put us probably
200 basis points to 300 basis points below where we expected to be.

Finally, on slide 19, let's take a quick look ahead to the second half, because I do realize that we talk
about this being an annual business and therefore what happens in the year is probably most important to
us. We had said on our last call that we expected our revenue split for the year to be about 35% first half,
65% second half. We are roughly in that range. As you have undoubtedly seen, we are still forecasting
that our revenue range is going to be $55 million to $60 million for the year.

The non-machine run rate is very positive and if we simply did four times where we are, we'd be in the
$20 million to $21 million range, which would be great growth in non-machine and a great foundation for
the business. We see significant and very strong demand for our direct printing machines. We have said
publicly that we expect to sell 18 metal machines to outside customers this year and we believe strongly
that we will do that. If all of that happened, if the non-machine business came in where we expect, if we
get that level of direct printing demand that we expect, we would need only to have about the same level
of sand machine demand for this year that we had last year to achieve our revenue goals and we are
clearly in line to do that. Reflecting back on Kent's comments, there is no doubt that what's in the pipeline
is a far greater magnitude and quantity than what we had at this time last year.

With that, I'd like to turn it over to Brian Smith, our CFO, to talk about the financials for the quarter.

Brian W. Smith: Thanks a lot, David. Good morning, everyone. If you could please turn to slide 21, we'd
talk a bit about gross margins. If you look at the Q2 2014 margin versus Q2 2013 margin, David had
mentioned the ExCast development costs that are in Q2 2014, additionally we have two new PSCs in Q2
2014 that are still being built-out, compared with Q2 2013, and that caused under absorption, which was
expected. If you look at our mix in Q2 2013, we were over 60% in machines versus non-machine,
impacting the Q2 2014 margins which came in around 22.3%. The trailing 12 months, again, were
impacted by the same ExCast development costs realized in Q1 and Q2 of 2014, the impact of mix between machine and non-machine revenue, as well as under absorption of overhead associated with the newly ramping up PSCs.

If you could turn to slide 22, looking at SG&A, David had mentioned the investments in people to be able to grow. Kent mentioned the ability to handle the growth that we expect not only in 2014, but beyond. We do largely built-out in those investments. Impacting 2013, I want to make sure that it’s clear, there was a $6.3 million equity charge in that trailing 12 months versus $1.1 million in the Q2 2014 trailing twelve months period. Right around $1.1 million is our current run rate relative to our equity compensation amortization.

If you turn to slide 23, you can see the growth in R&D, particularly in the trailing 12 months. The R&D investments have been in the material development that we discussed, as well as the new machine development. Those costs have been accelerating as we accelerate our efforts. Therefore, we’re revising our guidance on that, and you hear about that a little bit later.

If you could turn to slide 24, we talk about capital available for growth. You see we had $98 million in cash at the end of 2013. We are now at $56 million. The reconciliation of that is largely the two acquisitions that we made, of approximately $10 million, as well as about $18 million in total CapEx, which includes amounts of our own machines that were built in inventory and moved over into our own PSCs to fund our growth, as well as our investment in working capital.

I think I commented last quarter that we expected working capital to increase, particularly through the June 30 period, as we build out inventories for anticipated machine sales as well as the moves that we’re making in Augsburg and in North Huntingdon, so that we would not have any disruption in machine shipments. We are prepared for that. We don’t really have any changes in our debt.

If you turn to slide 25, you see that this is a carbon copy of what we discussed with you last quarter. I will say that we’re probably trending toward the low end of that 2014 CapEx range at this point in time.

With that, I will turn it over to Kent for final comments.

S. Kent Rockwell: Thank you, Brian. Looking at 2014 guidance, we still are holding to our 40% to 50% growth rate, which would be $55 million to $60 million. The opportunities available to achieve it in non-machine revenues are something we’re very comfortable with. It’s all about machine sales.

In the case of machine sales, I do stated that we have over 50 qualified names we’re discussing on a weekly basis about potential deliveries through Q3 and Q4. The diversity and the richness of those discussions is very strong, from the standpoint of who these customers are, and so we believe that we can get to the revenue expectations in the realm of that 40% to 50% arena.

Obviously, we’re taken a historically big impact on gross margin, which drops us down to below where we would like to be. I have to say that we would like to think we could have avoided the loss that we took on this one funded project. This funded project was a learning opportunity and it also provided us with a very significant government-funded opportunity as we move into FY 2015. This learning opportunity demanded that we do everything to make sure that the customer was satisfied with the technology, even though it was a great expense to us. The margins came down and it doesn’t bother me, because as we move forward, the margins will get back up to our guidance levels and this is all part of being in that transition period.

SG&A is still running at about the same area, it’s actually higher than what it probably needs to be as we move into 2015, because we have some non-recurring expenses in 2014 that will start to go away.
R&D guidance is up a little bit, because we accelerated research efforts in certain areas, where we see proprietary development, and we are excited about that. It’s something that we don’t want to get into too much discussion until the patents get filed. Although we have moved into some customer discussions, we feel comfortable that that’s the smart thing to do.

Moving onto slide 28, the first bullet point is profitability. After looking at our report for Q1 and Q2, you probably think that’s a subject we don’t know anything about. However, we are extremely focused on it—we are well aware that we have to demonstrate profitability. When the money is out there and opportunities are out there, I am going to spend the money as wisely as we can to create the largest market opportunity as we can and I think that we are doing that fairly effectively.

We do understand that at some point, you look at your cash and you look at where everything else is and you say, we have to demonstrate our profitability to the market. We know that’s a big focus for 2015. We also believe that the opportunities we are generating, by the money that we are spending in 2014, are going to make 2014 a pretty exciting year for us. It’s going to come from machine developments that David addressed, four new machines and some enhancements on current machines, and it’s going to come from material developments. We are going to take some of our existing machines and introduce them into new markets, which we are not yet examining with customers, because frankly it’s technology applications, where we would not want to share it publically until everything is in black and white on the patent side.

From that perspective the one thing I’d like to say is that we see an increasing validation from our customers. If you look at who our customers are and what they are asking us to do, as well as the number of small funded research contracts that we are getting from major U.S. entities, I think that shows that everybody is starting to recognize that binder jetting has a very important and growing place. It’s not going to be the only game in town and we understand that there are competitors in laser-type technologies that are very important to certain aspects of it. But what we are recognizing, and what our customers are recognizing, is that we do have a cost-effective approach to 3D printing and that we have a very unique approach to certain market applications for which we are increasingly invested.

In closing, I’d like to say that there was a wonderful article in Tech Crunch, written by Matt Marx, about disruptive innovations. It explains why the big companies take so long to look at innovative technologies like ours before they really start to adapt to them, and I thought that this article really hit the nail on the head. The big guys wait intentionally to see where you are going to end up, and the big guys are now calling us on a more frequent basis. I think we are giving them their money’s worth in their wait-and-see approach, because it has been a little bit slower. It’s not like the consumer activities. This is exponential growth over a lower base.

We are quite pleased with our position, despite the fact that our numbers don’t look too exciting. We are spending our money wisely and we are confident that we are going to get to a profitable position. We invested very well with these machines and these materials. I think our future is looking quite positive.

Karen L. Howard: With that Melissa, we’d like to open up the lines for Q&A.

Operator: Thank you. At this time we be conducting a question-and-answer session. Our first question comes from the line of John Baliotti with Janney Capital Markets. Please proceed with your question.

John Baliotti: Good morning. Brian and David gave us some good color on the gross margins. Beyond the second half of the year, Kent stated that you will be very focused on profitability in 2015. Do you expect the impact of ExCast to be a one-time event? What about the other 400-600 basis points? Are you coming up off a low 30% gross margin underlying or is it something higher than that? I am trying to get
a sense of how you think you can get this behind you, and to get some color in terms of some of the accelerated investments you hadn’t anticipated, in addition to the lessons you’ve learned.

David Burns: Morning, John. Let’s go through the whole gross margin story. Average selling prices held up on machines. We’re very confident and content with that. And the gross margins on our consumables and on our PSCs were also about where we expected. We continue to absorb build-out costs. As you know, we’ve added three PSCs, and there is significant cost yet to be observed and those are still impacting gross margins until we get up to a full run-rate at those facilities.

As a volatile business, we tend to have things happen that are not necessarily easy to forecast. If you were to ask me what’s going to happen next, the answer is that I’m not sure, because I’m not sure what might come up. Of course, things happen with some regularity, and I would say that as we expand the revenue base, the impact of these unpredictable things is going to become less and less, especially on the ExCast side.

We don’t anticipate anything near the kind of magnitude that we saw on this particular program in the first and second quarters, but I think it would also be naïve to say that we don’t think that as we take on new challenges and new projects that were considered unmanufacturable a year or two ago, that we aren’t going to hit some bumps. I think Kent’s point always is, address it and get it behind you when you see it, and don’t dwell on it or do it a second time.

John Baliotti: Right. Obviously, it would seem that you entered into ExCast hoping for a much smoother transition. In terms of lessons learned, however, it also seems as though we can expect difficulties for anyone else that tries to do this, especially since you’re going to have IP around it. I’m seeing, potentially, two positive things here—the new business opportunity resulting from taking on this project, as well as the overall reduction of headwinds due to the extra cost you’ve incurred this year. Is this a fair way to characterize it?

David Burns: That’s very fair John. In one sense, to be honest, even though the impact was strong on the P&L, I’m proud of what we’ve done. We’ve done something that I’m not sure anybody else in the world could have done. We’ve been told that by the customer. On the one hand, it’s been expensive and difficult. On the other hand, we pulled off something that was near impossible. We’re pretty proud of that.

John Baliotti: Just one more, then I’ll jump back in the queue. In terms of R&D, the information you’re given on the call today has been helpful, because when you look at the R&D going up $1 million on both ends, without the call you don’t know if it’s more expensive or if you’ve entered new ventures, and it appears to be the latter. As Kent pointed out, you’ve uncovered some opportunities, and you want to make the investment right now, to seize these opportunities. Is that a fair way to characterize the adjustment to R&D for the year?

David Burns: Absolutely, John. We could have looked at our second quarter financials and decided to dial everything back, because we were worried about the P&L. We’ve done the opposite. We’ve put our foot harder to the metal. We are working harder on machines. We’ve putting more research into machine development than we anticipated even six months ago, and our material side is pretty frantically working on new opportunities. I feel positive about all of that stuff.

John Baliotti: Great. Thank you.

Kent Rockwell: I’d like to add that what’s happened is some of these developmental things occur and you see the solution, you accelerate the investment because it’s apparent where you need to go and you want to get there quickly.

John Baliotti: Okay. Thanks, Kent.
Operator: Thank you. Our next question comes from the line of Sherri Scribner with Deutsche Bank. Please proceed with your question.

Sherri Scribner: Thank you. I want to just get a sense of opportunities you see ahead in the second half of the year. I know that you mentioned, I think you said 50 named customers that you are working with. Looking specifically on the metal side with M-Flex, you reiterated the goal of doing 18 machines this year. I want to get a sense of how confident can we be of that, what are you hearing from customers? Secondly, when do you expect to start to shift to the M-Print machine for customers? Thanks.

David Burns: Thanks, Sherri. In terms of prospects for the M-Flex, we have extraordinarily high confidence in a whole grouping of orders. I wouldn’t have used the number 18 again unless I was pretty sure we were going to get there. Actually, we’re beginning to offer the machine globally, you may know that at the end of last year, we were restrictive about the market that we were trying to serve with those machines, that being the U.S. market. Earlier this year, we brought in our entire global sales team. We’ve expanded the reach of the machine itself and opportunities have clearly resulted from that. We have a lot of confidence, and it’s going to reach a very broad global market, not an individual industry or an individual region. Regarding, the M-Print platform for 2014, I don’t want to absolutely make a commitment on that yet because we’ve got development work yet to do, but I feel pretty confident that we’re going to get at least a machine or two this year.

Sherri Scribner: Great. Thank you.

Operator: Thank you. Our next question comes from the line of Ajay Kejriwal with FBR Capital Markets. Please proceed with your question.

Ajay Kejriwal: Thank you. Good morning. There was good color on the gross margin on the call, and I appreciate that. When you talk about guidance for the second half, it seems to imply 40% plus, I guess part of that’s related to the expenses tapering down. Could you give a little bit of color on what’s baked into that second half gross margin ramp beyond expenses not being there?

Brian Smith: Hey Ajay, it’s Brian. Here are a couple of thoughts on that. We expect significant machine sales in the second half, as David said earlier, that’s the normal trend. If you look at non-machine revenue, we believe we have the same types of rates of growth that we’ve experienced; that’s a pretty steady business. The mix that David mentioned will be a little richer. We will have some additional costs associated with the ExCast build-out that is in those projected amounts. I hope that gives you some clarity for what our thinking was on the margin.

Ajay Kejriwal: Good. One more for me and I’ll pass it on; what’s your expectation for cash usage in the second half? I know you have some CapEx plans, but beyond that?

Brian Smith: Yeah, I think, I said last quarter we were targeting $50 million at the end of 2014. We now expect our cash balance to be in the $45 million to $50 million range at year-end. I think working capital will come down a little bit in the second half, as we ship machines and we bring inventory down. We have to bring inventory down a little bit because we’re moving, particularly in Augsburg, and that will disrupt production for some short period of time. As I said, we’re now expecting the low end of the range of CapEx that we’re given of $31 million to $34 million.

Ajay Kejriwal: Thank you.

Brian Smith: Yeah.
Operator: Thank you. Our next question comes from the line of Ananda Baruah with Brean Capital. Please proceed.

Ananda Baruah: Hi. Good morning, guys. Thanks for taking the question. Kent, could you clarify the comments you made about non-machine revenue for the second half of the year, in terms of what you believe you can do? Are you seeing that you’ll hit the revenue guidance with flat machine revenue year-over-year?

Kent Rockwell: All right. I’m going to let David answer the question. Maybe you didn’t quite understand my answer. This is not about flat machines.

David Burns: No. I think if we just model $55 million to $60 million, and we look at it vis-à-vis 2013, we expect to see, and I think there is a clear signal that we will, grow our non-machine business by approximately $7 million year-over-year. We were at $38 million last year, so that would take us to $45 million with no change in machine business.

We also know that we will easily ship a dozen more of our direct printing machines, the M-Flex category of machines, than we did last year. This should contribute between $4 million and $6 million, depending on options and furnaces and that kind of stuff. Suddenly, you’re into the $50 million range with no growth in sand machines.

I think the comment referred to this fact, that significant growth in the non-machine category, and significant growth in direct printing would still put us in the low $50s million, even if we had relatively flat sand machine volume for the year. Targeting $55 million from our perspective is not unreasonable.

Ananda Baruah: Got it. Makes sense.

Regarding machine opportunities, Kent put some context around the second half of the year, saying that there are about 20 machines in the September quarter and about 30 in the December quarter, around 50 in total. Things are clearly accelerating nicely, in terms of the opportunities that you’re seeing. What is the appropriate context that you use around those metrics? Is there a convert rate that you typically look at with regards to new opportunities that helps you track how much of those might generate revenue over any given period of time? I’ve just been looking at the opportunity of growth on a year-over-year and sequential basis.

Kent Rockwell: No. I’m looking at the order book and saying, okay how many of these customers are saying that they’ll take a machine in a certain quarter, and when we look and say there is 20 in Q3 and can we get 10 or 12 of those in that timeframe. Some of those will push into Q4 and some of the Q4 prospects will push out, that just seems to be the nature of the stuff moving to the right. What we are seeing is now customers coming in that are ordering multiple machines over a period of time for delivery; we’re got customers that want three or four machines. That’s a good verification that we’re going in the right direction.

The piece that is not in here is the fact that we have some new technology that’s going to apply to different industries and different industrial applications, and which we’re very reluctant to even tell people where we’re going with that, and that’s how we’re going to hit in 2015.

Ananda Baruah: Yeah. That’s the material for which you’re filing the patent.

Kent Rockwell: Yeah.

Ananda Baruah: Got it. Thanks a lot.
Kent Rockwell: Sure.

Operator: Thank you. Our next question comes from the line of Jason North with Jefferies. Please proceed with your question.

Jason North: I was looking at ASPs. Could you talk a bit in terms of M-Flex versus S-Max pricing? When you launch the M-Prints, what will that mean for ASPs?

David Burns: Jason, all along for the Lab platform we’ve used a number of about $100,000 to $125,000. For the Flex platform, we use approximately $400,000, and for the Print platform as it exists, I think $850,000 to $900,000 as an ASP, and about $1.4 million for the Max platform. The Print platform, once it is adapted for direct printing, will be a bit higher. It won’t be the same number, but it won’t be 50% higher. You could probably estimate $900,000 to $950,000 as our price book number. I would say that if you simply took the volumes, which you saw in the press release and you multiply times those ASPs, you get a number that looks a lot like our machine revenue for the quarter.

Now, the one difference was that we did ship a Russian machine, which we said would go last quarter and that selling price was a chunk higher. That was closer to $2 million than it was $1.5 million.

Jason North: Okay, great. I think previously you talked about a second ExCast project with your lead customer that was ramping in Q2. Can you give any indication of how that went and how that’s going, any sense of a potential follow-on?

David Burns: Yes. We have a second committed project. We are in the design phase. As you might expect, the lessons learned from the first project are being applied and we would expect a much better outcome from a margin perspective.

Jason North: Okay. My last question here, for full year 2014 your non-machine revenues, do you have any general sense of what percent of that will be ExCast revenue? Where that number could potentially go for 2015?

David Burns: In 2014, of the $20 million to $25 million, I won’t say the number is de minimis, but it certainly isn’t a significant percentage. Most of that is consumables, service and output from other PSCs. For 2015, the ExCast revenues that we’re expecting now may be more directly tied to funded research projects than they are to direct casting projects for customers.

Kent Rockwell: There is a lot of opportunity in some of the things that we’re looking at.

Jason North: Okay. Great. Thank you.

Operator: Thank you. Our next question comes from the line of Weston Twigg with Pacific Crest Security. Please proceed with your question.

Weston Twigg: Thanks. First of all, the lessons learned from the big project you were working on in Q1 and Q2. The limitations you encountered with the materials and the new binders you were working on, does that in anyway limit your market opportunity versus your previous expectations, particularly in the aerospace industry?

David Burns: I don’t think so. I mean, I think to do a real postmortem on what happened and how would take a lot longer call with a lot more detailed technical discussion about specific steps. Generally speaking, I don’t think we have endured limits on our opportunities. Conversely, the fact that we have achieved what we have has already caused us to see that there is more opportunity than we would have thought even six months ago.
Weston Twigg: Is there more risk heading into Q3, where some of the solutions that you've come up with won't work, and we see another surprise in the P&L next quarter?

David Burns: We've already acknowledged in our margin forecast that there is going to be some spillover into Q3. At this point, what I would say is our margin forecast for the remainder of this year fully embodies everything we know and expect to happen relative to ExCast.

Weston Twigg: Okay. Additionally, I'm a little surprised that you haven't shipped more metal machines in Q2 or Q1. I'm wondering the reason why the sales have been so low in the first half and that the order book is so high in the back half?

David Burns: I would say, it's simply the cycle that many machine tool companies see, the capital acquisition cycle at large companies tends to follow this pattern. Last year, we had no shipments of M-Flex machines until the end of the year and we shipped a bunch, because a bunch of people came in mid-year and said they had funding and wanted to go ahead. Right now we're working a bunch of projects that are funded, and they're available for capital this year and we're going to ship them in Q3 and Q4. I don't know how to explain it and I would change it if I could, but all I can tell you is that is the cycle and we are very much subject to that cycle.

Weston Twigg: All right. Fair enough. Thank you very much.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of James Medvedeff with Cowen & Company. Please proceed with your question.

James Medvedeff: Good morning, and thanks for taking my questions. My first question is, are the new service centers at this point fully utilized?

David Burns: No, James, not at all. In fact, when we announced that we were opening two on the West Coast, the point of announcement was to make sure that people understood we're going down that path. The actualization of them, one was late last year when we got started, and the second one was actually into the early part of this year. For the second of our West Coast PSCs we're less than six months in, and we had talked originally about an 18-month development cycle to get them up to even close to capacity.

I would even say, at this point that that development cycle maybe protracted even from the 18 months. We are in the early stages of both of our West Coast facilities and, of course, we absorbed a bunch of costs in Q2 to get Italy started, and we don't have the machines installed there yet. We are very early in the cycle in three of our PSCs.

James Medvedeff: Should we expect the PSC margins to continue to absorb that overhead?

David Burns: Yes.

James Medvedeff: Okay. The second question I have is, when you've finished with all the consolidation of production capacity, what will the capacity be? How many machines per month, or per quarter, or per year is the target capacity in Germany?

David Burns: Well, that's a hard question to answer simply because different machines take up a different amount of floor space and they have different build cycles. Generally speaking, around the world, we have the capacity to build out machines at a rate that's at least 2x what we have had previously, and probably even higher than that.
James Medvedeff: In the fourth quarter of last year you shipped 12 units, and now you’re talking about delivering 20 or 30 while in the midst of consolidating or moving, with the goal of getting everything into one facility by November. I am wondering if there is enough capacity there to deliver the number of units you need to get to the numbers for the second half?

David Burns: The answer is absolutely, yes. If you look at our working capital, you can see we’ve built out in advance a significant number of machines specifically to address our perception of market demand for the year. We’re not concerned about capacity this year.

James Medvedeff: Okay. That’s great. And then, my final question is, it sounds like the cadence of the rest of the year is that Q3 is sort of a snapback from Q2, and then Q4 is where you really make the year. Is that fair?

David Burns: That’s the way it feels to us, yes.

James Medvedeff: All right, thank you.

Operator: Thank you. Ladies and gentlemen, we’ve come to the end of our question-and-answer session. I’d like to turn the floor back to management for closing comments.

S. Kent Rockwell: Yeah. Again, thanks everybody for joining us. We appreciate you taking time this morning to listen to our story. Our financial results were not admirable when you consider the non-recurring charges that were associated with ExCast, and I want to say we were naive about some contractual aspects of dealing with large companies, but we’re getting through this. The good news about it all is that, even though it cost us lot of money, the customer is satisfied and we’re going ahead with some very large program proposals, which I think are going to bode well for us in 2015.

We’re excited about the progress that we’re making in all these areas of machine development and the improving clarity for the role and acceptance of the binder jetting technology. It’s absolutely evident now from the customers that we’ve got and the things that we’re doing that binder jetting in their minds has a place and we’re just trying to exploit those places most effectively.

We’ll be updating you again on the following quarter in November, and I think that you’ll see the results starting to show up at that point in time, as we’ve said, particularly with increased machine sales and as much as we’re weighted that way in Q3 and Q4. Thank you for your time. Good day.

Operator: Thank you. This concludes today’s teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful afternoon.