



Nanotech Security Corp.

Fourth Quarter 2018 Results Conference Call

December 19, 2018

C O R P O R A T E P A R T I C I P A N T S

Monika Russell, *Vice President, Finance*

Troy Bullock, *President and Chief Financial Officer*

Douglas Blakeway, *Chairman and Chief Executive Officer*

C O N F E R E N C E C A L L P A R T I C I P A N T S

Gianluca Tucci, *Echelon Wealth Partners*

Benjamin Jekic, *GMP Securities*

William Gibson, *ROTH Capital Partners*

Jordan Steiner, *Lester Asset Management*

P R E S E N T A T I O N

Operator:

Good afternoon, and thank you for joining us to discuss Nanotech Security Corp's Results for the Fourth Quarter and Year End ended September 30, 2018.

On this call today, we have Doug Blakeway, Nanotech's Chairman and CEO, Troy Bullock, Nanotech's President and CFO, and Monika Russell, Nanotech's Vice President, Finance.

At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up.

I will now turn the call over to Monika Russell.

Monika Russell:

Good afternoon, everyone, and thank you for attending our conference call for the fourth quarter and year ended September 30, 2018. Doug Blakeway will begin the call today with an overview of our year and a brief discussion of our results. He will also provide details of the Management changes and transition we announced today. I will then provide a detailed review of our financial performance for the quarter and year. Following the financial review, Troy Bullock will provide an outlook and our initial goals and expectations for 2019. Following the formal presentation, we would be pleased to take questions.

However, before we talk about results, I'd like to remind everyone that certain statements in this call may be forward-looking in nature. These include statements involving known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those expressed or implied in our forward-looking statements. For caveats about forward-looking statements and risk factors, please see our MD&A for the year ended September 30, 2018, which can be found on our Company profile at sedar.com.

Also, as part of the Company's business involves dealing with security features for bank notes, you'll appreciate that we are quite limited in our ability to provide details about specific customers and prospects. That said, we will do our best to provide investors with general feedback we are receiving from our customers, the industry, new opportunities that we are pursuing, and give some general parameters on how these development contracts normally advance into full deployment of security features on bank notes.

I will now pass the call over to Doug Blakeway. Doug?

Douglas Blakeway:

Thanks, Monika. Good afternoon everyone. Q4 was a strong quarter for Nanotech. We reported record revenue of over \$3 million in the quarter. Gross margin was 78%, and the Company reported net income of \$770,000. This was also the sixth consecutive quarter of positive Adjusted EBITDA for the Company. We ended the quarter and year with a strong balance sheet, with liquidity of \$9.6 million and no debt. On an annual basis, we ended Fiscal 2018 with revenues up 25% year-over-year, and we generated Adjusted EBITDA of \$2 million. This was in line with the guidelines that we have provided at the beginning of last year.

Nanotech benefited from several key developments in 2018 that have strengthened the Company and set it up for future growth. First, we executed on our \$30 million development contract, and it continues to progress as expected. This contract is to develop bank note security features that incorporate our KolourOptik and optical thin film, or OTF technology. We believe we are very well-positioned with this customer, and anticipate this development work may lead to Nanotech providing security features on their future bank notes.

In 2018, we also started to transition the Company into a product and marketing company. We launched our first branded bank note product, entered into distribution agreements for the Indian market, and added Joe Vosburgh to the Company as Vice President of Marketing. Mr. Vosburgh brings over 20 years' experience in the successful development and commercialization of breakthrough technologies.

In the third quarter, we unveiled M2, our first KolourOptik product for the bank note market. This ultra thin security feature, which combines multi-directional movement with clear, colorful images, and incorporates high definition nanotech and nano QR code detectable by Smartphone cameras, is a first in the market. Industry experts responded very favorably at the product launch, and since revealing the new product, we have had interest from both issuing authorities and potential bank note partners. We are excited about the market potential for M2, particularly as we have proven that we can produce it in format and quantities that can be applied to any bank note substrate.

We also look to diversify beyond the bank note market this year; in Q2, we finalized our supply and license agreements with our Indian partners, Holostik and Kumbhat, to initially address the tax stamp and pharmaceutical markets. Both Holostik and Kumbhat are currently supplying the Indian government with tax stamps, and have a significant customer list that includes pharmaceutical and consumer product companies. Kumbhat and Holostik are also pursuing other opportunities in India outside of the tax stamp market using optical thin film and KolourOptik products. Revenues from these partners, which we initially

anticipated to commence in 2018 have been delayed. Currently, these partners have begun to market Nanotech's KolourOptik and optical thin film technologies in customer proposals.

As many of you know, for the last two years we've been working with our partner, Hueck Folien, to participate in volume, optical thin film and licensing opportunities. While we continue to support Hueck Folien, to improve the quality of their high volume production, we are no longer actively trying to qualify as an optical thin film supplier for the ¥100 bank note, or more commonly known as the large Asian customer opportunity. We are instead pursuing other volume and licensing opportunities with Hueck.

We also made significant capital investments in 2018, including a state-of-the-art e-beam lithography system used in making KolourOptik images, along with additional development and production equipment for our KolourOptik and optimal thin film advancements. These investments will ensure we are able to continue to expand research and development and scale our in-house production.

I'm pleased with the results and achievements in 2018, and believe the Company is well-positioned, both financially and operationally, to execute on its growth plans. Two-thousand and eighteen was a transition year for the Company, and as you saw announced today, the Board and I have adopted a succession plan where I will transition my responsibilities to our current President and CFO, Troy Bullock, effective January 2, 2019. Under this plan, I shall remain with the Company as Founder and Chairman and will assist the transition through the ensuing few months.

What we have achieved as a Company so far has been tremendous. The next stage of our evolution as a Company requires an experienced operating executive like Troy to implement our sales strategy and advance the organization for future growth. I'm pleased to announce that the Board has endorsed my recommendation of Troy to be that leader. I'm fully confident that he will lead our Company to further success.

In 2018, we also strengthened the Management team with the addition of Monika Russell as VP Finance. Monika has over 15 years of experience in financial reporting and regulatory compliance in public company environments. Since her appointment, she has excelled as a leader in our Finance department and will now assume the role of acting CFO.

In closing, I would like to thank our stakeholders in supporting our long-term vision and the growth to-date, and trust they will continue their support through our next stage of growth.

I will now pass the call to Monika Russell to provide the detailed financial results for the fourth quarter and year-end 2018. Monika?

Monika Russell:

Thank you, Doug. Before I begin, I would like to mention that all the dollar amounts I refer to are in Canadian dollars, unless otherwise stated.

Starting with our quarterly results, revenues for the fourth quarter of 2018 were \$3.1 million, up 15% from the fourth quarter of 2017. This increase was primarily due to the timing of a recurring annual OTF order, which was recognized in the fourth quarter of 2018 versus the third quarter of 2017.

Gross margin for the fourth quarter was 78%, which was six points lower than the fourth quarter of 2017, as a result of changes in our revenue mix. Our operating costs for the fourth quarter of 2018 were in line with the fourth quarter of 2017. We were able to manage our costs, even after adding additional staff and expanding our lab space in 2018.

Net income for the fourth quarter of 2018 was \$770,000 compared to a net loss of \$301,000 in the prior year. The difference was primarily due to increased revenue and reduced depreciation and amortization expenses, reflecting the Company's declining balance depreciation policy and the intangible assets being completely amortized as at September 30, 2017.

Adjusted EBITDA for the fourth quarter of 2018 was \$1.3 million, compared to \$1.1 million in the same period of 2017. The difference is primarily due to increased revenue in the current quarter.

Turning to our annual financial performance, our 2018 revenue was 25% higher than the prior year as a result of expanded development contract revenue. Gross margin for 2018 remains strong at 78%, compared with 81% in the same period last year.

Research and development expenditures of \$1.4 million for 2018 were 5% lower than 2017. This decrease was mainly due to a larger portion of salaries and other expenses being allocated to cost of sales for paid development projects.

General and administration expenditures for 2018 increased by 10% to \$2.5 million. This increase was due to salaries, increased rent and other expenditures related to the expansion of our Burnaby lab facilities.

Sales and marketing expenditures of \$2 million for 2018 were consistent with the prior year spend. Depreciation and amortization expenditures for 2018 were \$1.5 million compared to \$2.8 million in 2017. As noted earlier, this reflects the Company's declining balance depreciation policy and the intangible assets being completely amortized as at September 30, 2017.

Other income for 2018 was \$372,000, an increase of \$1.6 million compared to other expenses of \$1.2 million in 2017. The increase is primarily due to the repayment of data in the third quarter of 2017.

Adjusted EBITDA for 2018 was \$2 million compared to \$1.2 million during 2017. The improvement reflects an increase in development contract revenue, partially offset by an increase in general and administration expenditures.

Net loss for 2018 was \$46,000, a significant improvement compared to a net loss of \$4.8 million during 2017. The improvement in our bottom line reflects the 25% revenue growth, reduced interest and lower amortization expenses. The Company remains debt-free, and we ended the year with a strong liquidity position of \$9.6 million. Overall liquidity decreased by \$1.3 million over the year.

Our operations generated cash of \$1.5 million, and we made capital investments of \$2.7 million during the year. We also invested excess cash in term deposits, shown as short-term investments on our balance sheet to generate additional interest income.

This concludes my comments on our 2018 results for the fourth quarter and year-end. I will now turn the call over to Troy Bullock to provide an update on our outlook for 2019. Troy?

Troy Bullock:

Thanks, Monika, and good afternoon everyone. As you've heard from Doug and Monika, 2018 was a solid year for Nanotech, and we continued to strengthen the Company and lay the foundation for future growth.

I now want to discuss Nanotech's outlook and goals and initiatives that I will be focused on in the first nine months as CEO. As Doug mentioned at the start of the call, Nanotech's position in the bank note market

continues to strengthen. Our strategy to become a key supplier in the multi billion dollar bank note security feature market is on-track. We are gaining recognition from central banks from our KolourOptik images, which provides a full spectrum of colors, customizable images and multiple types of motion. This is in stark contrast to the limited palette and rudimentary motion of the industry-leading products today.

In the commercial markets, we continued to advance the positioning of our KolourOptik technologies as an upgrade or a replacement to traditional holograms. We are excited about the many use cases that our KolourOptik technology makes possible, potentially enlarging our addressable market beyond just holograms. In 2019, we expect to introduce new products into both the bank note and commercial markets to make significant investment into building out our sales organization.

Management has established the following goals for the 2019 fiscal year. First, we will create a direct sales force to accelerate the sales process by focusing on direct sales in addition to working with key partners. The Company will also put in place a more scalable sales process that will focus on diversifying our customer base and demonstrating our competitive advantage to the bank note market—sorry, the bank note product line sales, and commercial sales. To-date, we have focused on large opportunities developing customized offerings on an indeterminate timeline. We will develop a more traditional sales pipeline with defined products targeted at both small and large customers by creating the necessary processes and channel development strategies required.

Second, in the bank note market, we have two areas of focus: contract development activities, and creating dedicated bank note product line. Currently, we generate most of our revenue from development contracts with a single customer with a goal of incorporating a Nanotech security feature on their bank note. This work is progressing very well, and the customer has narrowed the scope of their development activities, which could see us move to manufacturing production volume samples in Fiscal 2020.

We also plan to brand our currently unbranded products, such as OTF, and extend the product line with a new version of M2. We believe that creating a bank note product line will be able to showcase the various applications for our technology in a manner that our customers can easily relate to. These types of opportunities happen frequently on a regular basis and regular timeline. There are a limited number of competitive variables, which include the spectrum of colors available, whether a customized image can be used, and the types of motion available. We know that we can compete very favorably on all three areas. Our product line will also enable central banking customers to have a full menu of options based on their needs and cost parameters.

Third, and moving on to the commercial market, we plan to launch a new line of product offerings featuring our KolourOptik technology which will be specifically targeted to commercial markets. We are also in the process of securing a reliable and timely manufacturing solution for commercial size quantities of KolourOptik labels. Previously, we relied on large partners that were prohibitively expensive or took several months for delivery, making selling to smaller commercial customers difficult. By implementing these strategies, we believe we'll be able to sell directly to a commercial customer and deliver a complete authentication label that will enable the customer to showcase their brand identity.

Finally, we want to do a better job of showing off our products and technology. We have found that both our potential customers and potential investors require help visualizing how our product fits with bank notes and commercial goods. Rather than appear with a roll of labels or images, we want to show KolourOptik products incorporated into the bank note itself or on the packaging itself, so people can literally see the use case. We also want to enhance our web presence, so that the customers and investors can see how our products compare to the competition.

I want to reiterate our confidence in the sophistication and uniqueness of our technology, and the significant revenue potential it has across many markets. We are confident that our M2 product and our

development contract are on-track for the successful incorporation of revolutionary security features onto a bank note, which would lead to long-term recurring revenue.

Diversification into commercial markets is also expected to help stabilize revenues and earnings. However, in the short-term, while Management builds out its sales strategy and product offering, the Company's financial performance may be variable.

Given these initiatives, Management is forecasting the following for 2019. First, based on our current visibility, and conservatively assuming no additional contracts that we would win during the year, revenue may decrease by 10% to 20% compared to 2018. The Company will continue to generate most of our 2019 revenue from development contracts with a principal customer.

While we are getting closer to reaching the goal of incorporating a Nanotech security feature on this customer's bank note, advancement towards this goal corresponds with the customer narrowing the scope of development activities with an intention to select a final security feature. This selection could see us move to manufacturing production volume samples in Fiscal 2020. While focusing on the security feature is a positive development, because the scope of work has been reduced, overall 2019 revenue may be somewhat negatively impacted.

We continue to operate under an agreement to provide up to \$30 million of research and development services. As of September 30, 2018, only \$10.5 million of this revenue has been recognized, which leaves a further \$20 million available for the future. We are currently forecasting an Adjusted EBITDA loss of approximately \$1 million for 2019. Potential declining revenues and increased investment and expanded sales efforts and product offerings are anticipated to reduce near-term profitability.

As we enter into 2019, we are confident with our positioning in the market. We have a highly differentiated technology and are poised to add the products, delivery and sales resources to capitalize on it.

With that, I would like to end my portion of the call by saying I'm very excited by Nanotech's opportunity, and I want to thank Doug, the Board of Directors and Management team for the support and confidence they've shown in me. We are already well into the advancement of our commercialization strategies, so 2019 should be a year of exciting developments.

With that, I'd like to pass the call back to the Operator, James, to open up the call for questions. James?

Operator:

Thank you. If you'd like to ask a question, please signal by pressing star, one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star, one to ask a question.

We'll take our first question today from Gianluca Tucci with Echelon Wealth Partners.

Gianluca Tucci:

Hi guys, good evening. I guess first on the sudden CEO announcement. What prompted this change, and is there any change in the strategy or vision going forward for the Company?

Douglas Blakeway:

Hi, Gian. It's all centered around what we've achieved as a Company so far; it's been tremendous. We've reached early-stage commercialization based on our robust technology platform, and our ongoing R&D

contract with an issuing authority is progressing well. We've got a terrific, strong balance sheet, and achieved positive operating cash flow during this year.

It's always been the goal that I transitioned across to a new CEO in the coming months, and we felt, because of these conditions, this was a very opportune time to transition. To achieve the next stage of evolution for the Company, we will benefit from having that experienced operating executive, like Troy, to implement our sales strategy and advance the organization for future growth. I'm really pleased that the Board has endorsed my recommendation of Troy, and I'm fully confident that he will lead our Company to further success.

In saying that, it all centered around the conditions and moving to the next stage, and the conditions were all right so the timing was perfect.

Troy Bullock:

Gianluca, it's Troy, I'll just add to that. I've had a great privilege of working with Doug for the last four years and we've been working on the strategy and the direction together and establishing where we want to take the technology and the approach to the marketplace. I think the change going forward is—now, I'm going to be more actively involved in the sales side of the organization and driving the revenue line. Strategically, I don't envision any immediate changes or any significant changes. It's really going to be adding the execution, if you will, to the sales side of the organization, developing the products and driving further growth for the Company.

Gianluca Tucci:

Yes, that's what it seems like. Just on that point, it seems like you're foregoing relying heavily on your partners to help sell your technology and developing a direct sales model there. How does this change the economics of how you generate your revenue going forward, by going direct as opposed to relying on partners to help sell your technology?

Troy Bullock:

Yes, a good question; and I wouldn't say we're going to not rely on our partners. What we found in the past is that we were overly reliant on those partners. We've got great reputation with many of the large players in the industry. We sell some product to them; we certainly partner with them, we meet with them on a regular basis and they certainly have significant interest in our technology. However, they often have their own technologies, and for us to try and work with them, we're often at odds as to getting their full attention.

What we want to proceed forward with, and we'd sort of established this probably six or nine months ago and are just now starting to put it into effect, is that we want to have a dual-pronged approach, one where we want to have our own sales force where we have the capability to go directly to a central bank and provide them with a finished product, or we can partner with an intermediary that can integrate our technology into their product or product something for us. It's not like we have to go one versus the other. We want to leverage those good partnerships that we've already created, but we also want to have the ability to deliver direct to the end customer as needed.

Gianluca Tucci:

Got you, okay, thank you there. Then just one more and then I'll hop back in the queue. Guidance for Fiscal 2019 is mainly assuming only that development contract is to one customer. How is this advancing,

and where are you at the India tax stamp opportunities and all of the other verticals that you're chasing and the consumer goods, and the pharma specifically?

Troy Bullock:

Yes, a few questions there. You're right; I guess, first and foremost on the guidance side, as I highlighted in the opening remarks, we're at a very good stage with the customer. We've been working with them now for the better part of two and a half years, a little more than that, I guess, and they've been looking at a number of different technologies and looking at what we might be able to do with the technology for potential consideration for their bank notes.

I think at this point, we're quite confident now that they're narrowing the focus of that down to a single specific set of technologies, and the progress that we're seeing by the central bank is very encouraging. They've explicitly told us that they would like to put us forward as a recommended security feature.

We're also now meeting progressively with more senior people within the departments of government. Last year, our customer had us researching several different technology features, and now we have narrowed that significantly. This stage, for us, we'll begin to demonstrate our ability to produce high volume samples, so it's sort of moving from an R&D stage to more of a production and volume sample stage. This narrowing of focus may result in near-term revenue decline, but it's a significant advancement in that we've reached the milestone and positions us well to move forward to get onto their bank note. It's tremendous where we've achieved, and there is a short-term impact on revenues but it's definitely a major advancement for us to move forward onto that bank note.

Outside of the bank note, really our approach—as we sort of outlined in the opening comments, is multifaceted. We want to take what we've learned so far over the last number of years and identify products that we can market—a specific set of products to go into the bank note space and a specific set of products to go into the commercial space. With those products, we're then able to have our own sales force, but also work with partners, and go in and sell a specific product as opposed to a wide-ranging technology that we can create many different things out of.

By having more focus and a specific product offering, we're able to leverage those products to see more customers, and ideally diversify our customer list and build out a much broader sales funnel.

Gianluca Tucci:

Okay. The guidance is excluding any impact of additional contracts secured in Fiscal 2019. Yes, that's a conservative expectation or a conservative approach to Fiscal 2019, but is it a realistic approach to 2019?

Troy Bullock:

Yes, it's fair. I mean, we still do have some work to do to achieve the revenue forecast that I outlined, but we're not assuming new contracts. Realistically, we're building out our sales organization immediately, starting in January, and it's going to take some time. Even as I look forward to this year, there's a remaining nine months left in the fiscal year, so our ability to impact are going to be limited. But there's going to be a number of things that we are intending to do, regardless of what the sales are going to be in the near-term. We expect to provide significant validation of our strategy through adding a sales leader, near-term product launches, marketing materials, adding some smaller sales wins along the way and demonstrating progress of the demand. It's going to be a systematic approach to building out that organization over the next six months.

As you run that all down to numbers, it's hard to say; I've sort of given you a sense as to what we have clear visibility on now, and now we're going to go out and attack the other markets —both the commercial market and the bank note market, other players in the bank note market, to diversify our customer base.

Gianluca Tucci:

Okay, Troy, I appreciate the color here. Thank you.

Troy Bullock:

Thanks, Gianluca.

Operator:

Next, we'll hear from Ben Jekic with GMP Securities.

Benjamin Jekic:

Good afternoon, just have a couple of questions, Troy, for you I guess. Just on building the sales force; can you provide some—I'll sort of ask a few sub-questions within it. Can you maybe provide some numbers as to—are you going to double the expense, or how many people are you adding?

Maybe the second one is, are these going to be seasoned professionals in the bank note and commercial market, or coming from different areas that are going to require some time to get trained on your technology? Can you elaborate a little bit on that?

Troy Bullock:

Sure. Thanks, Ben, yes, let me see what I can add to that. One of the first things that I want to do, and I plan to do it immediately, is to hire an experienced sales leader who can both actively participate in significant account sales, but also has the experience and organizational skills to build out and run a sales team.

In addition to that, we'll be hiring additional sales support staff to support the individual—and then only once we feel like we've created a repeatable sales template will we go ahead and start adding additional sales staff. But, I'm hopeful that that will take between six months to nine months, and we intend to be extremely focused on penetrating the market. The type of individual that I have in mind and that we're looking for is really an experienced salesperson, not necessarily somebody from the industry. We've already got Igi LeRoux who's our Chief Business Development Officer who is tremendously well-connected in the marketplace, has a tremendous reputation and can get us into any central bank around the world. Having a partner with him that is a true sales professional is going to be extremely important for us to start converting our sales calls, if you will, or our business development calls, into actual recurring sales, but also into partnership opportunities with these customers.

I think from a cost-wise standpoint, Ben, currently we're about 28 people; I'm budgeting at this stage that by the end of the year we'd be up closer to 35 people. Really, the only senior person that we have in mind at this stage is the sales leader that would join the organization.

Benjamin Jekic:

That's as a whole, for the whole Company, an additional seven people?

Troy Bullock:

That's correct.

Benjamin Jekic:

Okay. Then my second question is, when you mention the kind of pace of conversion, of sales calls into revenue, can you—again, as specific as you can be, can you give maybe a range between—are some of the projects you're working on something that can be converted within three months, six months, nine months? What would be the sooner level of business, and something that might happen later? I'm just trying to gauge—like, is there a possibility that you actually exceed your fairly conservative estimates for 2019?

Troy Bullock:

Yes. I think, Ben, there's really two sides to the market, if you will. There's the bank note side and then there's the commercial side. Just talking about on the bank note side, one of the things that we're seeing on the bank note space is, we used to find—maybe going back a couple of years ago, that it was quite a long sales cycle, a long period. A typical country would have their bank note in circulation for seven or eight years, and depending on when you got in contact with them, you might have a fairly lengthy sales cycle before you go onto that bank note. We've been seeing, and the market's been seeing that contracting quite significantly over the last few years. Right now that's probably down to closer to four to five years. Now, that doesn't necessarily mean, on a bank note side, that you have to wait four to five years to get into that bank note, it just means that that's typically the life of that note in the marketplace.

We've seen examples where—certainly with some of our products like the thin film, where we'll be talking to somebody and they're looking for product within six months. We're bidding on that, we're working with them, we're trying to go through testing, but there are near-term opportunities that would happen within a six-month timeframe. At the same time in the bank note space, there's other opportunities for things like commemorative bank notes, which again have a much shorter cycle. With a commemorative bank note, countries are looking to celebrate some special event, and they're typically smaller volumes, but they're also very willing to incorporate new technologies.

As we look into expanding our bank note market, the opportunities for us are to launch products, work directly with central banks, work with our partners, pursue the commemorative bank notes but also pursue the traditional bank notes, but through partners and selling it as a product, as opposed to a customized technology.

On the commercial side of the business, it's quite different. The commercial side of the business, as we've talked in the past, we've got tremendous application for our product. One of our challenges in the past is that we've met with such a range of different potential customers that we were offering them a range of different offerings—and we've learned a lot from that over the past number of years. That's allowed us to gather that information, bring it back and start to now refine that information into a single product offering that we think would have mass appeal into those commercial markets. We're not going to be offering everything, but we're going to be offering a single set of products targeted specifically for the commercial market, and more importantly, or equally importantly, having the ability to deliver that to them immediately.

In that side of the market, we could see the sales cycle there being several months, two, three months, demonstrating a product, having interest from a customer and then delivering immediately thereafter. Those sales might be smaller, but some of those opportunities are quite large as well. Having a direct

sales force and being able to call on multiple customers and demonstrate to them that we have a complete product offering targeted at that market is going to go a long ways to helping that.

Benjamin Jekic:

Okay, and the last question I have is in terms of your large customer for whom you're doing the development contract; so you're mentioning that in 2020 you're going to engage in generating production level samples. Can you—that's still not money in circulation with your design feature, is that correct—and how—like, what's the—kind of the most optimistic, blue sky scenario at which point you could—like, if you win that mandate, when will that be evident in revenues?

Troy Bullock:

Yes. Ben, let me provide a bit of color to that, and at this stage we're not permitted to disclose the release date of the future bank notes. They are starting to disclose it to us, but we're not in a position where we can disclose it publicly.

What I can speak to generally, though, is how it may impact our revenues. During Fiscal 2019, due to the focusing of the development activities, we may see a decline; but as we move into 2020, we would look to expect to be manufacturing volume samples, which would mean significant production activity in our Thurso facility, which in turn would mean significant revenue opportunity. I'd also add that, in the bank note market, a prominent security feature like what we're talking about here would typically command somewhere between \$7 million and \$15 million for a billion bank notes. We haven't disclosed who our customer is, but that gives you a bit of a sense as to what that opportunity is once you're onto that bank note. I guess the point I'm also making is that the revenue increase and the revenue ramp-up can happen and will happen significantly before that bank note is in circulation.

Benjamin Jekic:

Okay. Just—if I can slide in one more, again, just to reiterate, to my understanding you are the only Company in that process, like there's no—they're not working with another partner. I mean—at which point they might decide between the two of you or the three of you?

Troy Bullock:

That is our understanding. That's what we've been told explicitly.

Benjamin Jekic:

Okay, okay, perfect. Thank you so much.

Troy Bullock:

Thank you, Ben.

Operator

We'll now hear from William Gibson with ROTH Capital Partners.

William Gibson:

Thank you. Could you give us a little more color on the tax stamp and pharma market in India? Just how large is that, and exactly what does that encompass in tax stamps? It sounds self-explanatory, but what actually goes on there and what are they trying to prevent?

Troy Bullock:

Yes, hi, William. In the tax stamp market, if we talk about it just around the world first and foremost, they're producing about 140 billion tax stamps every year. A tax stamp, we see them every day. There'll be a label that's on your package of cigarettes or your liquor bottle to demonstrate to the government that the taxes have been collected on that item. They range from a number of different sizes, and they're generally used in all countries around the world.

The Indian market's quite a significant market, somewhere in the neighborhood of 20 billion to 40 billion tax stamps are being produced in India. Our approach to that market has been to reach out and find some local companies that are currently producing tax stamps in that market that wanted to upgrade their technology. The two partners that we've signed up, we've worked with them for the better part of 18 months, qualifying them and ensuring that they could produce our technology in their production facilities. That process has maybe taken us a little longer than we would have hoped, but we are very satisfied and as are they, that that production capability is in place.

We're now at a stage with them where they're marketing our products to their customers and to other, I guess, provincial governments in India to win tax stamp business, but also pharma and packaging and foil manufacturing business where they're traditionally putting on a holographic label of some sort, they're upgrading it to one of our KolourOptik technologies. That's the sort of business they're bidding on right now.

William Gibson:

Okay, thank you.

Troy Bullock:

You're welcome. Thank you, Will.

Operator:

Our next question comes from Jordan Steiner with Lester Asset Management.

Jordan Steiner:

Hey guys, and Troy, congrats on the new role.

Troy Bullock:

Thanks, Jordan, good to hear from you.

Jordan Steiner:

Good to talk to you guys, it's been a while. Just looking at the press release, and you talked about moving to higher volumes of production with the large development contracts starting in Fiscal 2020. Would that imply, under that contract, a step up in revenue at that point versus what you're forecasting for '19 from that customer?

Troy Bullock:

Yes, that's what we're anticipating. To be clear, we haven't laid that out in a schedule for them, that's something that we're talking about now. As you go through that next stage and they transition to actually testing volumes, they literally start to look at, do we have the ability to produce the quantities they're looking for, can we make billions of these and run them through the gamut of testing that they would want to see to ensure if it incorporates correctly into their bank note.

To do that, obviously, we would need to hire a significant number of people on the production line and operate the equipment and facility—I don't want to say necessarily on a full time basis, but a significant amount more than what we're doing now, which would obviously lead to significantly more revenues.

Jordan Steiner:

Right, and then, thinking historically, and obviously you guys have never been this far down the road before, but for the industry in general, once a security item is chosen for that level of development and tested, where you're mass-producing at that size, what percent of the time does that actually translate into being on the final note?

Troy Bullock:

I don't think I can really say. I mean, we've certainly researched and have followed timelines with this specific customer, and in each of the cases that we've looked at, they've been successful. I can't make a general comment around all countries around the world and what do they look at and do they always get onto a bank note, but I know we've looked very closely at the history of this customer, and certainly in the past as they've moved forward to that level of selecting and starting to move into the testing phase, if it progressed into the final bank note.

Jordan Steiner:

Sure. Then, discussions with this customer, have they revolved around a specific note, or could it be multiple notes?

Troy Bullock:

It's been around multiple notes.

Jordan Steiner:

Okay, very good. Switching gears for a second, just on India. Is there any Indian revenue baked into the forecast you gave for next year?

Troy Bullock:

At this stage, nominal.

Jordan Steiner:

I mean, versus what, I guess, we were expecting initially, has that changed given the selling method—initially, one from you guys going direct, and now you're working with the two distributors built into their marketing book so the revenues could come much quicker once a customer makes a purchase decision.

Troy Bullock:

Yes, I think certainly one thing that's changed is that our understanding of the process has grown as we've worked with the customer. Going back nine months ago, our understanding was that—we had certainly been pretty close to qualifying them as a manufacturing producer at that stage. We were anticipating that, later this year, they would be talking to their existing or customer base and successfully driving revenues into that. We put contracts in place and agreed on pricing, and we had done all the steps for that.

I think a couple of things have happened within their production facility where we needed to ensure that the quality of what they were producing was going to be at the right level, and so there was a bit more of a qualification exercise. But, I think more so has been—now that we've even passed that stage, they're out now preparing marketing information. They've been preparing the marketing information for the better part of a few months, and running around in proposals, and we're into proposals. Maybe we didn't have that visibility before, that it would just kind of be an instant sale, was kind of what we were thinking was going to happen. Instead it's a bit more of a sales cycle from them as well as they convert the governments over from their traditional holograms into our technology.

The problem we have now is that we don't really have much visibility into that. We can see the activity; we talk to them every week, we know who they're marketing to, we know how many proposals we're going into. We like what we're seeing, we like the feedback we're getting, but I'm really reluctant to say—well, and we're confident that that's going to turn into x, y, z in revenue by this date. We just haven't seen that yet. Until we see a few successes of their customers converting over, at this stage we're not planning anything too significant from it.

Jordan Steiner:

That makes sense. I guess, thinking through the guidance, if there was a place where we could derive some upside to the guidance, some place with short lead times, it sounds like it would be in India.

Troy Bullock:

I think that's absolutely a place. I mean, there's several places to do that, Jordan. There is certainly that Indian market, there's us expanding and even doing better with our development contract partner. There is still possibility that we may need to do more work this year than was originally planned, so that's another upside opportunity. The commercial market, we've got these product launches we're excited for and we think that they're going to be something that can be more mass-produced and have more interest from customers. I think once we get those into the marketplace, that could be more upside revenue as well.

Even, I go back to that Hueck Folien relationship. The Hueck Folien relationship is still quite an important one, and although Hueck Folien, we've struggled with them and I think it's time for us to kind of move away directly from trying to sell into that China bank note, Hueck Folien is still very much a very respected player in the bank note space. They're significant, they're established, they're a supplier, they have a great reputation, and they've now got the ability to produce a wide roll of color-shifting film.

The challenge we've had with the Chinese bank note is, they have a very tight specification, and that—they've had troubles getting to. But our quality control team has now worked with Hueck Folien and worked with them over the last year and a half, and we're pretty confident that the quality of what they're making now, although it's maybe not quite there for the Chinese opportunity, it's definitely available for other opportunities in that space. We do see opportunities out there for other volume needs, for color-

shifting optical thin film, and we're certainly going to continue to support Hueck Folien and partner together with them to win some of that business. Again, not in our numbers right now, but something that is very much an upside potential for us.

Jordan Steiner:

Okay. Thanks guys.

Troy Bullock:

Thanks, Jordan.

Operator:

That will conclude today's question-and-answer session. I will now turn the conference over to Mr. Bullock for any additional or closing comments.

Troy Bullock:

Thanks, James. I would now like to thank everyone for your questions and for joining our Fourth Quarter and Year-End 2018 Conference Call. We are pleased with the financial results and feel confident in our go-forward strategy to expand our sales team, launch new products and diversify beyond the bank note market. I look forward to updating you on our continued growth path at our next conference call. Finally, I would like to take this opportunity to wish everyone a happy holidays and a prosperous new year.

I will now turn the call back over to our Operator, James, for closing details.

Operator:

This concludes Nanotech Security's Fourth Quarter and Year-End 2018 Conference Call. A replay of this call is available at 1-844-512-2921 for callers in Canada and the U.S. The pin number to access this call is 2410869. Thank you.