

Nephros Earnings Call – May 6, 2020, 4:30pm Eastern Time

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Kirin

Good afternoon everyone, this is Kirin Smith with PCG Advisory Group. Thank you all for participating in Nephros's first quarter 2020 conference call. Before we begin, I would like to caution that comments made during this conference call by management will contain forward-looking statements regarding the operations and future results of Nephros. I encourage you to review Nephros' filings with the Securities and Exchange Commission, including, without limitation, the company's forms 10-K and 10-Q, which identify specific factors that may cause actual results or events to differ materially from those described in the forward-looking statements.

Factors that may affect the Company's results include, but are not limited to, its ability to successfully, timely and cost-effectively develop, seek and obtain regulatory clearance for and commercialize its products and services offerings; the rate of adoption of its products and services by hospitals and other health care providers; the success of its commercialization efforts; the effect on its business of existing and new regulatory requirements and other economic and competitive factors.

The content of this conference call contains time-sensitive information that is accurate only as of the date of the live call, today, May 6th, 2020. The Company undertakes no obligation to revise or update any statements to reflect events or circumstances after the date of this conference call except as required by law.

I would now like to turn the call over to Daron Evans, Nephros' CEO.

Daron

Thank you, Kirin, and good afternoon everyone.

Welcome to Nephros' first quarter 2020 earnings conference call. This is a very unusual time for everyone. I want to thank all the front line health care workers, and all those who are providing the essential services that are keeping us fed and safe, while putting themselves at potential risk.

Today, we are going to run the call a little differently. I will not spend much time talking about the first quarter. Instead, I will talk about our view of what might be the new normal. I'll then turn the call over to Dr. Kimothy Smith, vice president of our pathogen detection systems group, who will spend a little time talking about his team's work, and some of the main issues buildings will face as we try to get America back to work. Dr. Smith will then turn the call over to Andy Astor, our Chief

Operating and Financial Officer, who will do a deeper dive into our Q1 2020 operating results.

Q1 2020 revenues were up 43%. Q1 generally provides a clear view into our base business, as the first quarter of the year is generally not a time where many outbreaks occur, due to the colder weather.

We were pleased with our 43% revenue growth, but did take note that only 8% of our Q1 revenue was from new customer sites, compared with prior averages of 30-40%. We took this as a leading indicator of a coming change in customer and prospect priorities due to the Covid-19 pandemic, and began to re-align some of our activities. As we moved into the second quarter, we identified a few key risks that needed to be addressed, to ensure our ability to maintain our high-growth momentum.

First, because we manufacture our medical device ultrafilters in Italy – the location of the first non-chinese hot zone – we were concerned about potential supply disruptions. To mitigate that risk, we increased our order sizes and added about a million dollars of additional inventory to manage through what could have been up to a six-month shut down. Thankfully, to date, our Italian partner has been able to manage through the crisis. We have had no significant shipment disruptions.

Second, we recognized – as did others in our industry – the risks associated with stagnant water in the pipes of office buildings, hotels, dormitories, and other buildings that have had less than usual occupancy over the last few months. Stagnant, warm environments are natural breeding grounds for waterborne pathogens. To that ends, we accelerated some of our pathogen detection research and expect to release a white paper in the coming weeks, comparing the building bacterial biome from an unoccupied building to that of an occupied building. This risk is real and we are working to understand more.

Third, we recognized that our customers would need to be singularly focused on their Covid-19 response programs, and that Nephros products – while still critical to their infection control programs – would probably take a back seat for a period of time. Accordingly, we shifted our focus towards the next steps in the life cycle of this crisis.

Among other focus areas, we are using our time to run more experiments to bolster our pathogen detection program. We have made great progress on our DialyPath system, which is designed to provide real-time endotoxin level estimates for dialysis clinics. We have also made significant progress on our SequaPath system, which is designed to provide a bacterial census of a building's water system – an estimation of a

building's bacterial biome, from a database of over 20,000 difference bacterial families. We will soon be releasing white papers on our most recent results from these two systems.

Before turning the call over to Dr. Smith, let me just provide a quick update on our hemodiafiltration system program. We are still on target to file the Special 510(k) this summer. We are currently in the process of manufacturing the systems and disposables that will be used for the last steps before completing the regulatory package, the verification and validation testing. Thus far, we have not had any COVID related delays on this project. We will hopefully, continue to avoid delays in the process, but will be using contract research firms to perform some of the testing, and therefore could be subject to their timelines.

Now I will turn the call over to Dr. Smith, who will talk in more detail about the most recent analyses we are performing to better understand the microorganisms around us.

Kimothy

Thanks, Daron. It's my pleasure to be on the call today, and to discuss a bit about our line of pathogen detection products: PluraPath, DialyPath, and SequaPath.

PluraPath is a mobile, quantitative polymerase chain reaction (qPCR)-based water-borne pathogen detection system that can

provide on-site, actionable data to infection control teams on up to 15 different pathogens in under one hour.

PluraPath allows our customers to understand the breadth of waterborne pathogens in their premise plumbing systems – not just Legionella, but Pseudomonas, Non-tuberculosis causing Mycobacterium, and Burkholderia, and many others. These pathogens are major concerns for certain segments of the population and are associated with HAI's – hospital acquired infections.

PluraPath is also appropriate for identifying pathogens in cooling towers, which are external to building plumbing systems. Cooling towers have been a difficult case for PCR-based methods in the past because of heavy metals and other substances causing inhibition of the test. We have developed a rapid, enhanced sample preparation kit which removes the inhibiting compounds but retains the DNA needed for the PluraPath testing protocol.

Our second pathogen detection product, DiallyPath, will be released later this quarter. DiallyPath is designed to provide real-time endotoxin level estimates for dialysis clinics by detecting and quantifying endotoxin-producing Gram-negative bacteria. In simpler terms, this means that DiallyPath can identify bacteria – which can cause inflammatory reactions – before they impact patient health.

The DiallyPath system is extremely sensitive and specific. It can detect levels of Gram-negative bacteria as low one bacterium per 100 mLs of dialysis water, or about one-trillionth of a gram of endotoxin per mL of water. And it can provide the specific identity of the predominate bacteria in a water sample.

The third product in our pathogen detection roster is SequaPath . To be released later this year, SequaPath will provide a window into the true microbial diversity in a building's plumbing system.

SequaPath extends the technologies of PluraPath and DiallyPath with the power of rapid, targeted DNA sequencing. It will provide an opportunity to understand the microbial community dynamics of building "biomes." As Daron mentioned earlier, there are risks associated with stagnant water in unoccupied office buildings, hotels, dormitories, and other buildings that have had little or no occupancy over the last few months. We are collecting water samples now and expect to write a white paper in the coming weeks on this topic, comparing the building bacterial signatures in unoccupied and occupied buildings. We are working to understand the potential risks of stagnant building water from a wholistic perspective, rather than through the lens of a single pathogen.

I will now turn the call over to Andy for a financial overview.

Andy

Thanks, Kimothy. I will now provide a look at our financial results for the first quarter ended March 31, 2020.

First off, I am very pleased to report our 15th consecutive quarter of year-over-year net revenue growth, with an average growth rate during those 15 quarters of 62%. Nevertheless, as Daron outlined, we have seen significant changes in customer priorities, and early Q2 has certainly seen a slower-than-planned start, particularly with respect to new customer acquisition.

Nephros reported net revenues in the first quarter of \$2.5 million, compared to \$1.8 million in the same period last year, an increase of 43%. Over 99% of these revenues were generated by our Water Filtration business segment.

Net loss in the Water Filtration business segment was (\$0.6 million), compared to (\$0.8 million) in 2019.

Adjusted EBITDA in the segment was negative (\$0.4 million), compared to negative (\$0.3 million) in 2019. Please refer to today's press release for more details about the calculation of Adjusted EBITDA and its reconciliation to GAAP net income or loss.

Additional information about our Water Filtration and Renal Products business segments and their operating results can be found in today's filing on Form 10-Q. Also, beginning with today's report, we are recognizing our Pathogen Detection business as a third business segment.

Consolidated

On a consolidated basis, net loss for the quarter was (\$1.1 million), compared with (\$1.3 million) in 2019, a 19% improvement.

Consolidated Adjusted EBITDA in the quarter was negative (\$0.8 million), compared with negative (\$0.9 million) in 2019, a 7% improvement.

Cost of goods sold in the first quarter was \$1.0 million, compared with \$0.8 million in 2019, an increase of 35%.

Gross margins in the first quarter were 59%, compared with 56% in 2019. We expect future gross margins to continue in the range of 55% to 60%.

Research and development – or R&D – expenses in the first quarter were \$0.6 million, compared with \$0.8 million in 2019, a 26% decrease.

Depreciation and amortization expenses in the first quarter were \$46,000, compared with \$50,000 in 2019, an 8% decrease.

Selling, general and administrative – SG&A – expenses for the first quarter were \$1.9 million, compared with \$1.5 million in 2019, an increase of 30%.

Our cash balance at the end of the quarter was about \$9.0 million.

A Thank You

I would like to take this opportunity to briefly highlight the charitable efforts of our own staff, led by Michael Milman, our vice president of R&D. Working with personal funds from the Nephros team, Mike and his staff worked tirelessly to import thousands of NIOSH-certified N95 masks, which they donated to more than 20 healthcare teams in the New York / New Jersey metropolitan area as well as other geographies in the US.

Closing

In closing, we remain resolute about staying strong during this extraordinary time, and excited about our future growth prospects.

We look forward to seeing many of you virtually at financial conferences this spring, and at our annual meeting, which will be held virtually on May 21. More details will be released soon.

In the meantime, please always feel free to contact Daron or I directly at info@nephros.com.

This concludes our formal presentation remarks. I would like to personally thank all of our stakeholders for their continued support and look forward to speaking with you again soon. We will take questions from the audience now, and also answer emailed questions as appropriate. Operator, please open the call for questions.