

SECOND QUARTER 2023 CONFERENCE CALL

Jess Jankowski, President & CEO

Thank you, Abigail. Good morning to all of those listening live, and we also welcome those who choose to listen later online. Thanks for joining us today for a discussion of our 2nd quarter 2023 results, the state of the business, and our outlook for the rest of the year. Kevin Cureton, our Chief Operating Officer, is joining me on the call today. Our prepared comments will be brief and, as always, we're looking forward to some good Q&A afterward.

Our second quarter was much stronger than the first, but still beneath our expectations when entering 2023. While there's definitely room for improvement, there's also definitely room for optimism as we assess our performance. On the last call, I mentioned that margin improvement and profitability are a major focus for the Company. We discussed the plans we've put into place, and I told you we expected to see at least a 2% improvement to gross margin this year. With that commitment in mind, it was gratifying to see the 31% gross profit in Q2, and also to see the improvement compared to the prior year's Q2, and the six-month numbers. These numbers are even better when taking into account that we had more than \$400K in Other Revenue in Q2 of 2022, which added about 4% to the quarterly margin last year and 2% to the six-month margins. If we pull this Other Revenue out, which practically represented all profit, year-over-year we saw a 4% improvement in gross profit for the 1st half, even after a historically tough Q1, and an 11% improvement for the 2nd quarter.

We continue to struggle with unsteady customer demand which, while continuing to grow, pops up and down month-to-month. This makes it challenging to predict future margins over short windows, like a three-month quarter. We've also historically struggled with getting product out the door, due to external supply chain issues and internal bottlenecks.

The good news here is that most of our external supply chain issues have been resolved. We've also seen some nice productivity improvements coming online recently, which will help to reduce internal bottlenecks. Kevin will touch on this during his comments as well.

Moving down the P&L, it's also important to recognize that we are incurring expenses relative to the litigation with BASF, that we believe will not reflect ongoing operating expenses once we resolve the open issues. We've spent roughly a million dollars here during the six months ended June 30th, distributed almost equally in the two quarters. That comes to a bit more than \$0.02 per share and, were these costs not incurred, we'd be looking at a profitable six-months and about a 7% net income for Q2. We did incur these costs, however, and we will continue down the path we're on, ideally to a negotiated settlement, but not necessarily so. We think we have a good case, and continue to work to resolve these issues with BASF as quickly and fairly as is practical. We're approaching this situation in light of our view that Nanophase and Solésence promise a great deal of unrecognized value that we intend to realize. We need to protect that value, and, ideally, help to expand both our Active Pharmaceutical Ingredient, or "API," business with BASF, by adding new products, which remains an ongoing discussion. We will also enhance that value by driving more growth through the expansion of our Solésence business.

Before we continue, let's walk through the numbers.

Unless identified otherwise, all numbers will be stated in approximate terms.

Our Q22023 revenue was \$11.9M, versus \$11.2M for the same period last year, up 6%. At \$11.9M, Q2 of '23 also represents the highest quarterly revenue we've ever recorded. A few short years ago, \$12M would have represented a pretty good year for your Company. As an additional point of reference, Q223 revenue exceeded Q123 revenue by 25%. For the second quarter of 2023, we had net income of \$337K, or \$0.01/share, which represented a multiple of 2022's 2nd quarter earnings of \$50K, coming in at well less than a penny a share. Looking at the six-month comparable numbers, We had \$21.3M in revenue in the first half of 2023, versus \$19.4M in the same period in 2022. This represented a 10% improvement year-over-year. Also, when looking at the strides made since 2022, note that we had a good deal of Other Revenue that came sources not directly related to product revenue, our core business. Looking only in terms of product revenue growth, the 6% improvement in Q2 goes up to 10%. Taken the same way, the increase for the six-month period goes from 10% to 12%.

These are good indicators of where our business is headed, and how we plan to strengthen it going forward. Our ongoing challenges are to balance production resources to demand, and to continue to increase throughput to help reduce our reliance on overtime and to avoid having unabsorbed direct labor during periods of waning demand. We have been having success in addressing these things. As we mentioned in the release, we recently commissioned our first fully automated filling process, enhancing throughput per labor hour by 100%. We continue to work to automate more of our processes where demand can support it, with expectations that this will bring benefits not only in enhancing our ability to deliver, but also to reduce costs. Keep in mind that, even without the additional automation, we're still producing at record levels. As we get our new Manufacturing organization humming, we'll continue to deliver on opportunities to produce more efficiently and profitably. We're in a good spot. As I mentioned last time, we are highly focused on increasing our margins, knowing that this will yield significant increases; first in profitability, then to our enterprise valuation. We're all investors in Nanophase and Solésence, and we all stand to reap the rewards we are working toward together.

Looking now at Operating Expenses, we saw R&D expense, which includes our engineering group, which were down a little from Q1, but up by 35% YOY. Roughly half of that increase was related to compensation expense. An important part of this came from the expansion of our Engineering team to help speed the build-out of capacity in our new Bolingbrook facility. These types of additions will pay for themselves. The rest of the R&D investment in people is to support the continued enhancement of our technology, our intellectual property, and, ultimately, our highly-rated line of award-winning innovative products. We operate in markets, particularly with respect to our Solésence business, where new products drive growth, and product lifecycles can be fairly short. We've made remarkable progress since we started developing and marketing our formulated products, and we're working to maintain the advantage we have!

Moving to SG&A Expenses, which were also down from Q1, were up just over \$1M YOY, to about \$4.3M for the six months of 2023. Of this increase, the lion's share related to the \$1M in BASF litigation costs we incurred this year. Again, we don't expect these to be ongoing expenses. Also contributing to this variance were smaller increases in compensation expense, insurance costs and audit fees, offset by reductions in bad debt expense and other items. We also saw interest expense more than triple, a \$280K increase from the same period in 2022, due to the combination of expanded borrowing and a 5% increase in the Prime Lending Rate over the past year or so. As you can see, we keep moving ourselves into a better position to win. We have maintained our focus on capturing the bottom-line benefits that

the changes we've implemented beginning in 2022 were designed to deliver. The bottom-line takeaway here is that we're focused, motivated, and working hard to build the value of our Company.

Now I'd like to introduce Kevin Cureton, our Chief Operating Officer, to discuss progress in some of these areas, and their drivers, in greater detail. Kevin?

Kevin Cureton, Chief Operating Officer

Thanks Jess. As always, I would like to begin by thanking our team for their efforts in helping fulfill our mission in enhancing people's lives through the world's best skin care products as we also work tirelessly toward creating a more valuable company for our shareholders. I also would like to thank all of our investors who remain steadfast in their support of our company. While it was nice to return to profitability in Q2, it by no means represents a finish line of any sort. Instead, Q2 represents us starting to realize our goal on achieving both growth in revenue and increased profitability. A critical part in achieving our goal is having the right team in place. We now, for the first time since we began the Solésence business, have a complete leadership team in place – in commercial, operational, and financial roles – that will serve as the team to lead us into the future. We have already demonstrated that our business processes enable us to sustain our status as world class innovators – our latest Cosmoprof award reinforces that. That is why we are increasingly focused on building the business processes that will enable us to become a best-in-class manufacturer and distributor. As our board often asks, how will this translate – what are the KPI's that will demonstrate that we are on track with achieving our goal? Achieving operational excellence translates into meaningful improvements in gross profit margins. Over the next two quarters, that will primarily be through improvements in two key areas - our labor efficiency and lowering materials costs. While 31% gross profit was certainly a significant improvement over the underperformance we had in the previous 3 quarters, we believe there is much more improvement that can be realized in a relatively short period of time. I'll end by saying that our confidence in the future is largely because of our confidence in our team's ability to achieve our mission – continued innovative leadership while simultaneously growing our profitability. They have the "right stuff" to achieve our vision but of course that must be proven during the rest of this year and the years to come. Jess?

Jess Jankowski, President & CEO

Thanks Kevin. Why don't we dig right into it? Although we know that most of our investors listen to the webcast, or review the transcript, after the live call, we'd like to invite those participating in today's call to ask any questions you may have, or to share your comments. Afterward, I'll offer a few critical closing comments.

Abigail, would you please begin the Q&A session?

10:15 AM

Q&A SESSION PLACEHOLDER

10:45 AM

Thank you, Abigail. As I mentioned, there are a few closing remarks that I want all of you to hear. Our story of the last few years has been one of unrealized value. We've become bigger and more stable, now we have to become more profitable, then, ultimately, more valuable. Demand for our products has not diminished. We're working hard to get them out the door faster, and to introduce more of them. Consumer preference continues to move Solésence forward, and it has had the effect of insulating us from the ups-and-downs in our economy. We're growing and winning awards, and winning new brand partners and consumers. Your patience is going to pay off as we transition through this next phase of development.

Thank you, again, for joining us today. We'll look forward to our next call when we expect to discuss further improvements to the profitability and stability of our business. Have a great day everybody!