CUI Global, Inc. Q2 2017 Earnings Conference Call

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Operator

Good day, ladies and gentlemen, and welcome to the CUI Global Second Quarter 2017 Results Conference Call. (Operator Instructions) I would now like to introduce your host for today's conference, Mr. Sanjay Hurry. Sir, you may begin.

Sanjay Hurry

Thank you, Kaleigh. Good morning, and welcome to CUI Global's Second Quarter 2017 Results Conference Call. A copy of the Company's earnings press release and accompanying PowerPoint presentation to this call are available for download at the events and presentations page on the Investor Relations section of the CUI Global website.

With us on the call today are William Clough, President and Chief Executive Officer, and Daniel Ford, Chief Financial Officer.

The purpose of today's call is to review the Company's financial results for the second quarter and to provide you with management's perspective for the second half of the year. Following management's remarks, the call will be opened to questions and answers. A telephonic replay of this call will be available until August 23rd. You may also access the archived webcast and accompanying PowerPoint at any time on the Investor Relations section of the CUI Global website.

As a reminder, this call will contain certain forward-looking statements made within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended. Such statements are subject to risks and uncertainties that could cause actual results to vary materially from those projected in the forward-looking statements. The Company may experience significant fluctuations in future operating results, due to a number of economic, competitive, and other factors, including, among other things, a reliance on third-party manufactures and suppliers, government agency, budgetary, and political constraints, new or increased competition, changes in market demand, and the performance or liability of our products. These factors and others could cause operating results to vary significantly from those in prior periods and those projected in forward-looking statements. Additional information with respect to these and other factors which could materially affect the company and its operations are included in certain forms the Company has filed with the Securities and Exchange Commission. Before starting the call, be advised that management will attend and present at several investor conferences over the next two months. A full listing of these conferences will soon be made available for your reference under the Events and Presentations tab of the CUI Global website.

With that, I would like to hand the call over to William Clough, Chief Executive Officer. Good morning, Bill.

William J. Clough - CUI Global, Inc.

Thank you, Sanjay. Good morning, everyone, and thank you for joining us on our Fiscal Second Quarter 2017 Results Conference Call. I'll start with a brief overview of our performance for the quarter, after which Dan will review our financial results in greater detail. Once Dan has concluded his remarks, I will provide some additional commentary on some of the key initiatives we have worked on over the past several quarters. By strategically deepening our penetration of Europe and establishing a wider footprint in North America in our Energy segment, and across key partners and customers in both the Power and Electromechanical business segments, we are setting the stage for a strong second half of the year. So, let's get started.

Our financial results for the second quarter reflects further strength in our Power and Electromechanical segment, as the electronics industry emerges from a down cycle, and timing of custom project delivery schedules in our Energy segment. Let me address the performance of our Power segment first.

Revenue increased approximately 33% sequentially, driven by increased turnover through our distributors and continued sales to our direct customer base. Of note in the quarter, we saw excellent acceptance of our product line by our newest distributor, Arrow Electronics, as part of their initial rollout. Arrow is already reordering product and is looking to increase our presence in its offering. We believe there is much more upside for us in this relationship. Power and Electromechanical backlog was a very strong $19.2 million at June 30th.

In our energy segment, and in another milestone toward broad acceptance of our disruptive GasPT by the gas industry, Ofgem, the UK's energy regulator and internationally recognized energy authority, formally relaxed its technical requirements for calorific value determining devices to allow for deployment of our GasPT as a faster, low cost, and highly accurate alternative to the slower, more expensive gas chromatographs. Also, DNV GL awarded us a 36-month development contract as part of the UK's future billing initiative, using a modified GasPT product to study the technology and billing consequences of injecting biogas into the gas transmission network for residential customers. I'll have more to say on the opportunity that the future billing project presents to us after Dan's prepared remarks.

To continue the process of educating the industry participants on the value proposition of our products, we held innovation seminars in the UK and demonstrated our VE Probe's capabilities in the US that are generating new interest from gas operators. It is clear to me from these engagements that our products are now commanding the attention they deserve.

Our opportunity set is expanding, but the conversion cycle from opportunity to contract remains lengthy. As I've discussed on prior investor calls, decision making on infrastructure projects can be and is deliberative. But when you have a disruptive product set, as we do, and the industry knows that we do, decisions will be made, and they will be made for game-changing technologies like ours. At quarter-end, energy backlog stood at $16.4 million.

Now let me turn the call over to Dan Ford, our CFO, so that he can run through our financial results in more detail. Dan?

Daniel N. Ford - CUI Global, Inc.

Good morning, and thank you, Bill. I'll start with a review of our financial results for the second quarter of 2017, and then focus on our balance sheet.

Total revenues were $22.5 million, a decrease of 3% from $23.1 million in the second quarter of 2016, reflecting a $2.8 million increase in revenue in our Power segment, offset by $3.4 million in lower revenue in our Energy segment.

Power and Electromechanical segment revenues were $18.2 million, an 18% increase year-over-year. And on a sequential basis, Power segment revenues increased 33%. Since the end of 2016, the Power segment has seen a pick-up in order flow compared to last year, as distributors and customers build inventory, while the electronics industry moves into an upcycle.

Energy segment revenues were $4.3 million, a decrease of 44% year-on-year, due to the impact of unfavorable exchange rates on our UK operations, the timing of customer project delivery schedules, and the temporary halt of deliveries of gas-related metering, monitoring, and control systems, including GasPT units to Snam Rete in Italy.

Consolidated backlog was $35.6 million at quarter-end, comprised of $19.2 million for the Power and Electromechanical segment, which is up substantially over last year, and $16.4 million for the Energy segment, compared to $15.7 million at June 30th of last year. Energy backlog this year did not include any GasPTs for Italy, whereas last year, the backlog included GasPT units bound for Italy. Instead, the increase in energy's backlog year-over-year is attributable to strong integration orders at both our UK and Houston facilities, in conjunction with a slower first half of 2017, and deliveries of projects due to customer schedules.

The second quarter consolidated cost of revenues as a percentage of revenue increased to 63% from 60% last year. For the six months ended June 30, the consolidated cost of revenues as a percentage of revenue increased to 66% from 61% in the prior-year comparable period. This percentage varies, based upon the product and project mix shift within both of our business segments, as well as contract labor costs within our energy segment and foreign exchange rates.

During Q2, the Power and Electromechanical segment cost of revenues as a percentage of revenue was generally consistent at 64%, compared to 65% in the prior Q2. In the Energy segment, cost of revenues as a percentage of revenue for Q2 2017 was 62%, compared to 52% in the prior Q2. For the six months ended June 30, the Power and Electromechanical segment cost of revenues as a percentage of revenue was 66%, compared to 64% in the prior-year comparable period. During the six months ended June 30th, Energy segment cost of revenues as a percentage of revenue was 65%, versus 54% for the six months ended in 2016.

The Power and Electromechanical segment remained generally consistent for both the three and six months ended, with the changes attributable primarily to product mix sold. The increase in the cost of revenues as a percentage of revenue for the Energy segment during the three and six months ended June 30th is the result of a less favorable product mix, due to the aforementioned temporary halt of deliveries to our customer in Italy of higher-margin technology-based product sales.

Gross profit in the second quarter was $8.2 million, for a 37% margin, versus $9.2 million, or a 40% margin in the prior year, reflecting changes in segment and product mix. The Power and Electromechanical segment generated gross profit margins of 36% that was flat with Q2 last year, and the Energy segment generated gross profit margins of 39%, compared to 48% in Q2 2016. For the six months ended June 30, gross profit was $13.9 million, for a 35% margin, compared to $17.2 million, for a margin of 39% in the prior year. The Power and Electromechanical segment generated gross profit margins of 34%, versus 36% last year, and the Energy segment generated gross profit margins of 35%, compared to 46% last year.

We are focused on improving margins within our Power segment through increasing efficiencies and controlling variable costs at our Canadian manufacturing facility, and through new product and technology introductions in the marketplace.

The Energy segment experiences improved margins when it sells more of its leading technology solutions, including GasPT and VE sampling systems, which offset lower margin integration-type project work.

During the second quarter, the Energy segment was more heavily weighted to integration, as our Italian project for GasPTs remained on hold. We continue to expect margins in both segments to improve during 2017 through improved product mix sales in both operating segments, and efficiencies at our Canadian manufacturing facility.

During the three and six months ended June 30, 2017, selling and general administrative expenses decreased $0.3 million and $1 million respectively, compared to the prior-year comparative periods. These decreases are largely due to $0.5 million and $0.8 million in severance costs incurred in the Power and Electromechanical segment for the transition of the R& D team to CUI Canada, and for various positions with the Energy segment during the three and six months ended June 30, 2016, respectively. In addition, the Company began implementing various cost saving measures in Q2 2017, which provided some benefits in Q2 and are expected to further improve SG&A going forward. SG&A as a percentage of revenue remained constant at 39% of total revenue during the three-month period ended June 30th, 2017, and slightly increased to 43% from 42% from the six-month period.

EBITDA loss for Q2 was $0.9 million, compared to an EBITDA loss of $0.5 million last year, for the reasons mentioned. For the six months ended June 30th, EBITDA loss was $4.1 million, compared to an EBITDA loss of $2.2 million in the same period last year. Net loss for Q2 was $1.6 million, or $0.07 per share, compared to a net loss of $1.5 million, or $0.07 per share last year. For the six months ended June 30, net loss was $5.4 million, compared to a net loss of $4.1 million in the same period last year.

Cash and cash equivalents stood at $1.8 million at June 30, 2017, a decrease of $2.8 million since December 31, 2016. We did not sell any shares under our at-the-market equity program associated with our S-3 filed on March 14th. With the report of our quarterly results this morning, we have terminated the at-the-market program effective immediately.

In terms of financing working capital, as a reminder, we have available liquidity from several sources: The potential sale and lease-back of our Oregon property, ability to finance our UK facility that we own outright, use of our $4 million line of credit and 1.5 million GBP overdraft facility, both with Wells Fargo, and our $100 million shelf registration. During the quarter, we placed our Oregon property on the market. After paying off the mortgage note from the expected sale proceeds, we expect to be able to put a substantial amount of cash on the balance sheet.

This concludes my prepared remarks. I will now turn the call back to Bill.

William J. Clough - CUI Global, Inc.

Thank you, Dan. Looking ahead, a robust pipeline of Energy segment opportunities and recovery in the electronics industry supports our ambitions for long-term growth. Within our Power segment, revenues to direct customers and through our distribution channel continues to increase, as the electronics industry moves into a upcycle. Together, with a stronger bid pipeline of integration projects in our Energy segment, we anticipate the full-year sales will be weighted towards the second half. As a reminder, integration projects carry a lower margin than our leading-edge technologies, such as the GasPT and VE sampling systems.

I started the call by saying that business development initiatives we have pursued over the past several quarters are starting to bear fruit. Demand for our energy products, especially our GasPT, is building across a broader base of prospective customers and geographies. Let me spend a few minutes on our business development initiatives that we believe can lead to greater energy product revenues in the second half of the year and well beyond.

For those of you who are new to CUI Global, our gas technology products are uniquely positioned to address operators' demand for technology solutions that enable sustainable energy, climate change mitigation, and the responsible use of resources. Starting with Europe, we have formally submitted a bid for 1,000 GasPTs for deployment by ENGIE's integration division, Endel, for biomethane-to-grid applications. We expect to hear back on our bid in the fourth quarter, after Europe's August recess. As a reminder, Endel intends to construct 1,000 biomethane-to-grid skids, and we expect purchase orders to match their build schedule.

With ENGIE, ours is a partnership that spans multiple points, for revenue across multiple geographies. In addition to GasPT, the product we developed based on ENGIE's odorizer technology, is quickly gaining traction in the marketplace, given its unique delivery method. Having licensed the odorizer technology just five months ago, we are already proceeding to field trials of this product in September. After completing the field trials, we will be able to start selling to customers. Snam Rete has already expressed an interest in purchasing up to 1,300 of these units, and ENGIE has indicated an interest in deploying it across its own transmission network. Additionally, and reflective of their aspirations for our odorizer product, ENGIE is folding it into their business development efforts in China and have scheduled meetings with potential customers, to take place shortly after we complete the field trials.

Staying with Europe, I'll touch briefly on the tariff issue in Italy. As a reminder, in regards to the tariff, this refers to the amount that Snam Rete is allowed to bill its customer, and not to taxes. Snam Rete management had a very productive meeting with the regulatory authority in June, but does not expect to hear back until sometime after the August recess. In the meantime, I want to stress that the tariff issue with Snam Rete in no way impedes the development of opportunities in other countries in Europe. To learn more at Snam Rete's commitment to our GasPTs, I invite you to visit the media room on our website, where you'll find a report authored by Snam Rete that details their network upgrade plans, including their intention to deploy a total of up to 7,000 units.

In a recent development, at the end of July, Snam Rete announced that it had secured a loan from the European Investment Bank in the amount of EUR 310 million to fund part of Snam Rete's EUR 600 million capital infrastructure plan, to upgrade the Italian gas network and to allow for optimization of its financial structure. You'll find a link to Snam Rete's press release in the media room section of our website.

In that press release, Snam Rete identifies four specific projects to be funded by its investment plan. We are very pleased to see that two of the projects pertain to CUI Global. The first is to the re-metering project, for which we already have a contract for GasPTs. The second is for the installation of odorizing systems for industrial customers. Our understanding of the odorizer project is that it cannot be accomplished with current odorization technology, which I believe makes our solution, with its unique delivery technology, a significant competitive advantage. Most significantly, Snam Rete's press release reaffirms its commitment to moving forward with our GasPT contract, and positions us well, for an odorizer opportunity.

Now let's turn our attention to the UK. Perhaps the most compelling evidence of our GasPT gaining momentum in the industry can be seen in the UK. Recall we were awarded a follow-on contract in May by DNV GL under the UK National Gas Network Innovation Competition as part of a project called Future Billing Methodology. This project seeks to unlock the full potential of the Gas Network to distribute unconventional gasses. The distribution of unconventional gasses, however, requires much more granular, and therefore accurate, billing, which GasPT can provide.

For those of you who aren't familiar with DNV GL, with $2.7 billion in annual revenue, it is the world's largest technical consultancy and supervisory to the global renewable energy and oil and gas industry. Its 13,000 employees and 3,000 energy experts support a global client base and help to establish industrywide technical and regulatory standards. You may remember, it was the company the US Government asked to investigate the Deepwater Horizon spill in the Gulf of Mexico. It is no coincidence that DNV GL is also the company from whom we acquired the GasPT technology. As a party to the future billing project, DNV GL seeks to combine its deep domain expertise with data from our GasPTs to create digital ecosystems that enable the building of new data-driven services. In this context, GasPT is the only viable data provider. It uses no service gas, needs no regular maintenance, and provides accurate, almost real-time data at a very reasonable cost.

On our last investor call, I spoke about the network innovation project deploying a number of our GasPT units, wirelessly connected to a sample of UK residential customers, designed to give homeowners the ability to see what they are spending on energy on a second-by-second basis. The goal in presenting this data in real time was to encourage conservation. Additionally, the project was designed to accurately allow for the broad use of biomethane and other low carbon renewable fuels, while still maintaining accurate billing throughout the network. I am very pleased to report that the initial results of this deployment have been quite positive. The purpose of this R& D project is to prove that broad deployment of an accurate metering system throughout the natural gas network would both encourage conservation, and more importantly, allow for the broader use of renewable green resources like biomethane, thus reducing pollutants and dependence on non-renewable resources. For more information, we have provided a link on our website within the Media Room section to the Future Billing Project website hosted by DNV GL.

If greenlighted, the project will proceed to the next phase, which involves design, development and planning for implementation. Deployment would begin in 2019 or 2020. To be clear, while we are in the very early days of this opportunity, we know two things. One, that our technology cannot be replicated by anyone else, and two, to be effective, the deployment will call for literally thousands of metering units. I will keep you updated on this substantial opportunity as it progresses.

Turning to North America, where we employ a multi-pronged approach to energy product sales, here the dominant application of GasPT is as a process control device for big, two-stroke, gas-fired compressors and the gas turbine power generation market. These are applications that do not require agency certifications beyond those which the GasPT already has in place. To enter this market in a significant way, we have been laying the foundation for a relationship with one of the largest turbine manufacturers in the world. Our goal is to be included in this group's bill of materials for their turbines. To that end, the manufacturer has been testing several of our GasPTs continuously. With significant progress made toward the approximate 8,000 hours of total testing time required, we estimate that this process will be completed in the fourth quarter. Our GasPTs have performed as expected and, with successful completion of testing, the next step will be certification of our GasPT as a standardized process control device for their large-frame turbine applications.

This certification opens three revenue streams for us with this customer. One, our GasPT will be included in the bill of materials for the large-frame turbines manufactured every year. Two, certification enables us to sell to adjacent groups within the manufacturer's organization as a preferred vendor with a certified product. New machines totaling several hundred units are manufactured annually by these other groups. And three, GasPT will be an approved product under the manufacturer's warranty. With approximately 25,000 of its turbines in the field today, we can approach them all with a manufacturer-approved, effective method of controlling their turbines. As much as $20 billion to $30 billion are spent annually on maintenance of these turbines, and GasPT can help save on those costs, as well as improve upon their environmental impact.

Fiscal monitoring with GasPT is another opportunity in North America. We are presently seeking certification from Measurement de Canada to sell our GasPT for fiscal monitoring applications. Concurrently, we are deploying two GasPT units to a large energy delivery company based in Alberta as part of a field trial starting in September, as a prelude to a project that could be in similar scope to our Snam Rete contract. These opportunities underscore our progress to expand the opportunity set for GasPT. Despite the interruption with Snam Rete, gas operators have moved forward with plans to deploy GasPT, principally because its ROI is very compelling. We have added ENGIE, which gives us multiple points of potential revenue across its integration subsidiary, Endel, where we have already submitted a bid for the 1,000 GasPTs for our biomethane-to-grid installations. ENGIE also operates a fleet of LNG tankers, storage facilities in Europe and China, and pipeline delivery systems throughout the world, all candidates for our unique technologies. In addition, the Future Billing Project could call for literally thousands of metering units. And finally, this Canadian opportunity is a beachhead to other opportunities there.

While GasPT dominates our opportunity set, our VE sampling system is also making clear headway in North America as well. We are currently in multiple sales cycles for sampling systems with some of the largest energy producers in the world. These opportunities have only increased after our industry demonstration at Southwest Research in Texas, and through the assistance of our continuing relationship with Daily Thermetrics, who continue to penetrate the burgeoning thermowell market.

Turning to our Power and Electromechanical segment, we have seen a significant uptick in customer orders and revenues, for several reasons. First, all our distribution partners are building inventory in our products. Second, our point of sale activity through those distribution partners are increasing, which, along with the investment in inventory, provides a stable flow of customers and design wins. Design activity is higher than last year, which makes us optimistic about being able to sustain sales levels and further grow it. And third, we won a number of higher production accounts that we were designed in during 2015 and 2016, that are now driving the increase in our direct business.

Now let me touch briefly on a key growth driver in the Power and Electromechanical segment, our ICE technology products. To remind you, our ICE technology products utilize Virtual Power Systems' Intelligent Control of Energy -- or ICE, -- software to provide peak saving capabilities and unlock under-utilized power capacity in data centers. Our ICE technology products are undergoing beta and sampling testing, and every tester is reporting good or better-than-expected results. We are currently seeking product certifications, including UL, for ICE Block, which we are working diligently to obtain in the near future.

Just yesterday, we announced a major milestone for our second ICE technology product, the ICE Switch. ICE Switch is a power monitoring and switching system that allows power to be intelligently distributed across racks, depending upon need and historical usage patterns. It is a complementary solution to ICE Block that we feel represents the next step in unlocking power capacity in data centers. In a press release yesterday, we announced the production release of ICE Switch, following the receipt of UL/CUL and TUV 60950-1 safety certifications. There is considerable interest from prospective customers for our ICE technology products, as data center power consistently emerges as the most critical area that needs to be addressed to support the growth of IOT, mobile, and supporting infrastructure. Our ICE technology can be a real game changer.

To summarize, our business development initiatives undertaken to drive market awareness and expand adoption of our energy products have begun to bear fruit. The opportunities ahead of us are many and substantial, borne of a product set that is unmatched in the marketplace. Given the totality of the opportunities ahead of us, our strong sequential financial performance, and continued upturn in the electronics market, benefitting our Power and Electromechanical segment, our substantial backlog for both business units, together with the sources of funding available to us, as detailed by Dan, effective with our quarterly report this morning, we are immediately rescinding the at-the-market portion of our shelf registration.

The management team and I continue to focus on executing the opportunities ahead of us to grow our revenue, to reach our goal of profitability, and to enhance shareholder return.

This concludes my prepared remarks. Operator, please open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Eric Stine with Craig Hallum. Your line is open.

Eric Andrew Stine - Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst

Hi, Bill and Dan. Maybe we could just start with Canada, I guess on the certification front. I mean, it sounds like you're working towards certification, and I'm wondering, is this a different certification than one you've been working towards in the past? I know that there was some hope that potentially, the European certification would apply to Canada. So maybe some color there and hurdles you need to get past. But also, curious to hear what your thoughts are on timing of those field trials.

William J. Clough - CUI Global, Inc.

Yes, the field trials, we believe, are going to start early September, and these are the same certifications that we've been working on. The good news is that we have convinced Measurement de Canada to accept the testing in durability, accuracy, and feasibility from the Italians, so they have accepted those. The only thing they want now is they want two of our devices to run on a Canadian pipeline, with a Canadian pipeline sponsor, for a period of somewhere between 60 and 90 days, so it's a very short test period, to prove that it works on the Canadian pipeline as it has on Europe. We have a partner who is participating with us. In fact, they're a sponsor partner. They are a large pipeline company in Canada, based out of Albert as we've mentioned, and like I say, we expect to deliver and install two devices to them the first part of September.

Eric Andrew Stine - Craig-Hallum Capital Group LLC.

Okay, but so the trials that you're mentioning, those serve two purposes. I mean, that's one for the certification, but then also, for that company working towards a larger deployment. Is that how we should think about it?

William J. Clough - CUI Global, Inc.

Exactly, exactly, and that actually worked to our benefit in the sense that when we finally got Measurement de Canada to accept the European findings, they [Measurement de Canada] actually presented us to this pipeline company as a partner and as a sponsor, and the pipeline company agreed, and yeah, you're absolutely right, they're [the pipeline company] using the test and sharing their data with Measurement de Canada, but using the test internally to make their own decisions.

Eric Andrew Stine - Craig-Hallum Capital Group LLC.

Okay, great. Great color there. Maybe just turning to ENGIE quick, so the 1,000 biomethane, or the bid that you've made, is that still the same situation, where really, you're the company that's involved there? I mean, is there any other competition in that, or do you expect to win it? And the, you know, last quarter you did mention you were expecting some near-term purchase orders. Are we talking about the same thing, in that those are potentially a fourth quarter event?

William J. Clough - CUI Global, Inc.

Correct, and yes, we're a component in this biomethane-to-grid skid. We're not creating the skids themselves. We do that in the UK, but in France, it's Endel who's going to create the skid. But we've been spec'd in as the analyzer portion of it, so I can't imagine -- frankly, no one else can meet the spec. the spec is no service gas, low maintenance, and a cost structure that only we can really meet.

Eric Andrew Stine - Craig-Hallum Capital Group LLC.

Got it, okay. Last question for me, this is for Dan, just on the cost savings you mentioned, you know, partial impact in Q2. Just more color on those, maybe what the impact was in Q2 and maybe what kind of run rate we should think about for OpEx going forward.

Daniel N. Ford - CUI Global, Inc.

So the cost in Q2 for the severance packages and everything was pretty de minimis. I'd say it was less than $100,000 US during the quarter. Long-term, what that's going to look like is about $1.5 million] annually saved in SG&A, so we're really going to start to see those saving starting to kick in in Q3, 4, so they were fully implemented during Q2.

Eric Andrew Stine - Craig-Hallum Capital Group LLC.

Got it. Thanks a lot.

Operator

Thank you. Our next question comes from the line of Joe Maxa with Dougherty & Company. Your line is open.

Joseph Anderson Maxa - Dougherty & Company LLC, Research Division - VP and Senior Research Analyst of Disruptive Technologies & Select Equity

Thank you. Back on ENGIE and the odorization solutions that you're coming up with, and you talked about field trials that I think you said are going to start. But I'm wondering how long those trials go as far as -- and then when, perhaps, you could see some purchase orders.

William J. Clough - CUI Global, Inc.

Yes, I think we're just finalizing the testing of the beta product, and we hope to get that product in the ground probably in the next month or two. We have been told -- and Snam is the one who's putting them in, and Snam has told us that they would like to see deployment the first part of next year. So taking that into account, I think that they're looking for somewhere around a three-month field trial. It's not extensive. It doesn't require the regulatory certification that the analytics do, obviously because it's not designed to measure quantity. It's simply applying an amount of odorant into the gas system, so I think it will be much less onerous, if you will, than the regulatory requirements, and I suspect it will be something in the three-month range. Like I say, they are pretty insistent about doing deployment with this re-metering project, which I think means that they're certainly going to be doing something by the beginning of next year.

Joseph Anderson Maxa - Dougherty & Company LLC.

And then, staying with the energy, on the gas turbine opportunity you mentioned, when are you expecting -- you said you expected the 8,000 hours to be completed by the end of this year. What would be the timeframe before you would expect to see perhaps some orders come from that?

William J. Clough - CUI Global, Inc.
We expect as soon as it's certified, that we would see an initial purchase order. We've already been told that we'll get a call-off purchase order almost immediately, so it will be very quick. It could be fourth quarter.

Joseph Anderson Maxa - Dougherty & Company LLC.
So after the 8,000 hours are done, you would expect to be certified quickly after that?

William J. Clough - CUI Global, Inc.

Correct. Oh yeah, they've said that as soon as the 8,000 hours are done, it will be certified. That's the only thing that's holding it up now.

Joseph Anderson Maxa - Dougherty & Company LLC.
I see, okay. And then, more in near term, on the backlg in Energy, how much of that is related to integration projects versus product sales? And I'm assuming --

William J. Clough - CUI Global, Inc.
I'd say 90% of it is integration.

Joseph Anderson Maxa - Dougherty & Company LLC.
Okay, so that's a longer revenue cycle to turn those projects versus -- which means that backlog you've got to stretch out over how long, a couple of years?

William J. Clough - CUI Global, Inc.
I think we usually say six to nine months, something like that.

Joseph Anderson Maxa - Dougherty & Company LLC.
Okay. Gross margins you talked about strength in the second half. Are you thinking you'll maintain or exceed levels from Q2?

William J. Clough - CUI Global, Inc.

Dan, you want to handle that?

Daniel N. Ford - CUI Global, Inc.

Yes, absolutely. I think we're going to continue to see strengthening in the Power and Electromechanical on the margins. On the Energy side, it's going to be -- I think it's going to be consistent with what it looks like right now. It's going to be consistent with where we're at for the first half of the year on the Energy side. Depending on timing of products, if one of our large GasPT customers kicks off an order, that will definitely lead to an increase in the gross margin, but at this point, conservatively, I would say it's going to stay consistent on the Energy side.

Joseph Anderson Maxa - Dougherty & Company LLC.
Okay, and I'll just ask one more. On the Power and Electromechanical side, order outlook for Q3 must remain pretty strong, based on what you've been saying. So I'm wondering if you expect sales in that line to exceed Q2 or somewhere along the same lines, and if you could keep that op margin at a nice op margin quarter in that segment.

Daniel N. Ford - CUI Global, Inc.

I think we're going to be right around Q2's levels, maybe just slightly less, based on the backlog schedule right now. But the ordering pattern has continued to be an increase. Each of the last 12 months, we've had increased orders, compared to the comparative trailing 12 months' period, so it's been a really good trend, and that's continuing right now. We continue to see, as Bill mentioned, good sell through, through distribution and through new direct orders, and we're getting new design wins on a regular basis as well. So the trend is very good, but I think it's going to be at/about the same as Q2, or maybe a little bit less for that division.

Joseph Anderson Maxa - Dougherty & Company LLC.
Okay, thank you.

Operator

Thank you. Our next question comes from the line of Rob Brown with Lake Street Capital Markets. Your line is open.

Robert Duncan Brown - Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst

Good morning. Just going back to the ENGIE bid for these skids (inaudible)

William J. Clough - CUI Global, Inc.

Hello?

Robert Duncan Brown - Lake Street Capital Markets, LLC.

Hi, can you hear me?

William J. Clough - CUI Global, Inc.
Yes, I can hear you.

Robert Duncan Brown - Lake Street Capital Markets, LLC.
Yes, so on the 1,000-unit order for ENGIE, or bid for ENGIE, what's the per-unit revenue potential or order revenue potential for that contract?

William J. Clough - CUI Global, Inc.

There's actually two components that we're bidding for. One is the RTU, the telemetry system, and one is the analyzer, the GasPT, and we haven't specifically revealed any of the pricing that we're doing with that on a customer-to-customer basis. And I would tell you that we're bidding on a one-off at this point. They're going to certainly want a discount based on volume, but I think you're going to see something in, for just the analyzers, something in the EUR 17,000 to EUR 20,000 range, and similar pricing for the RTU portion of it.

Robert Duncan Brown - Lake Street Capital Markets, LLC.
Okay, good. That's helpful. Thank you. And then on your [Oregon] facility discussion, you said that it was on the market. Could you outline the cash potential from that and the timeline you're thinking.

William J. Clough - CUI Global, Inc.
Dan, do you want to take?

Daniel N. Ford - CUI Global, Inc.

Absolutely. So we're being advised the selling price range is somewhere between $7.5 million to $8.5 million. I know that's a wide swath, but that's the range that we're looking at on that. We owe about $3.4 million on our mortgage for that, so the net proceeds, somewhere in the neighborhood of $4 million-plus to the company, after paying the mortgage off.

Robert Duncan Brown - Lake Street Capital Markets, LLC.
That's good; thank you.

Daniel N. Ford - CUI Global, Inc.

Thank you.

Operator

Thank you. Our next question comes from the line of Amit Dayal with Rodman &Renshaw. Your line is open.

Amit Dayal - Rodman & Renshaw Research - Analyst

Thank you; good morning, guys, and congrats on the strong second quarter. Just continuing the backlog, is most of this concentrated, especially on the Energy side, is it concentrated amongst a few customers, this backlog in the Energy segment?

William J. Clough - CUI Global, Inc.

I think if your question was, Amit, is it concentrated among a few customers, generally speaking, our energy, our future energy opportunities are with big, large pipeline companies, and so by their very nature, there's not a lot of them. There are a significant number in certain geographic areas. There is, for example, 210 pipeline companies in the US. But generally speaking, in Europe, there is one pipeline company for each country; they're nationalized or semi-nationalized. In Canada, there's really only two large companies, so again, you're right, it's a small customer set, but they're very, very large customers.

Amit Dayal - Rodman & Renshaw
That's good; that's helpful. And in relation to Snam Rete, you know, this recent move definitely seems really positive. Things seem to be on track except for these bureaucratic delays. You know, when you look at the odorizer opportunity, is that also sort of mired in red tape, or could it potentially move forward independently of the GasPT project you have with them?

William J. Clough - CUI Global, Inc.
I will tell you that my understanding of the deployment of the odorizers is that those are going to go into many of the same offtakes that the re-metering project is addressing. I believe that that was confirmed with their press release regarding the loan, as well, when they talked about odorizing certain large industrial customers, and that is exactly what they are doing with our re-metering project. They are re-metering their 6,800 largest industrial customers; that's what they're doing, and I think that their plan is to roll out the odorizer with not all of those, but I think a similar type of deployment.

Amit Dayal - Rodman & Renshaw
Understood; thank you. And then, you know, in regards to the ICE Switch offering that's coming out, we are reading a lot of interesting things, and there's a lot of positive things in the industry around this. Can you give us some color on how you think this sort of will scale up in terms of potential revenues, et cetera? And will you be relying on Arrow for this in terms of distribution, or are you doing this sort of organically?

William J. Clough - CUI Global, Inc.
We're doing this organically, actually, between ourselves and VPS. Dan, do you want to talk about that, the opportunity with ICE?

Daniel N. Ford - CUI Global, Inc.
Yes, so we think we'll get, immaterial revenues this year during Q4, particularly once the other ICE product becomes certified so we can go to market with both of them. We are gaining traction or interest already on the ones that we press released yesterday morning. So we think we'll get some revenues in Q4 this year, but really, we see a pick-up in 2018 and then, really, adoption in 2019 on a larger scale. So it's a big opportunity, but the way that we're going to market is actually going to be organic, and it's going to be a lot through the partners that have it in the beta sample testing right now. They're going to be doing a lot of the groundwork sales, because part of the sale is actually installation, and that's not something that we do. So it's going to be VPS and us in support of those entities which are, again, as we've talked about those five, we can't name them all, but we can, again, name Intel, since they self-identified at the OCP conference. But those companies will be targeting their customers with regards to either their server infrastructure that they're selling to those entities when they're doing installations; they'll be including this as the power system, or it will be through other large power system providers to data centers that will be actually doing the installation sale, and we'll be selling to and through them to the end customer.

Amit Dayal - Rodman & Renshaw
That's good, and that's all I have.

Operator
Thank you. Our next question comes from the line of Glenn Mattson with Ladenberg. Your line is open.

Glenn George Mattson - Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research
Yes, most of the questions have been answered already, but curious on just, you mentioned the ICE Switch and the UL certification that it just received. Wondering why the timing, why that came out first, ahead of ICE Block, and how much longer you expect for ICE Block, and, you know, just what the process is for that.

Daniel N. Ford - CUI Global, Inc.
Sure, so the ICE Switch is a complex device, but it is -- certifications for it, or for that type of product, exist today with UL and other agencies. The ICE Block, however, is an entirely new certification, an entirely new device, and it incorporates batteries, which have a longer certification period to get through the process. So we do expect that to come through. Later Q3 is the schedule I'm hearing right now. But again, it's mostly due to the battery. Batteries require a lot of extra safety testing and work, and there's different groups within the certifying agencies that certify each piece of it, and then it goes through as a consolidated certification as well. So there's three or four steps to getting that through because of the, really, the batteries. Batteries cause complexity in power systems.

Glenn George Mattson - Ladenburg Thalmann & Co. Inc.
Okay, great; that's helpful. That's it for me. Thanks.

Operator
Thank you. Our next question comes from the line of Bill Nasgovitz with Heartland. Your line is open.

William John Nasgovitz - Heartland Advisors, Inc. - CIO, Portfolio Manager, Chairman, and Director
Yes, good morning. Say, Bill, for years, we've been hearing about the great potential for these products and it's quite exciting. I just have two questions, really. First, on the ICE Block, ICE Switch area, how large is this market, and what's your conservative view of the potential share which CUI could possibly garner. And then secondly --

William J. Clough - CUI Global, Inc.
Thanks, Bill, and I want to address that. Oh, go ahead.

William John Nasgovitz - Heartland Advisors, Inc.
Secondly, the same for the energy side, what's the size and total of the markets that you're addressing, and what's a conservative view of -- we're talking about multi-year possible conservative share that CUI could garner in both markets?

William J. Clough - CUI Global, Inc.
Let me start with the ICE Block and let Dan handle that, and then I'll come back for the Energy. Go ahead, Dan.

Daniel N. Ford - CUI Global, Inc.
Yes, I'm pulling that up right now. It is quite large. So the market today, frankly, it's a multi-billion-dollar market, because power is the largest costs, other than actual hardware, within data centers. So the market -- hang on; I'm pulling that data up right now. Where we're at right now, there is no competing technology for it right now, so from the standpoint of actually doing peak shaving, there isn't competition. But there are other ways of managing power, obviously, in a data center whether they choose to adopt it. We are seeing the small-side scale for a data center, we're seeing in the $0.75 million opportunity for that size of a facility. We're seeing an average data center facility of about a $2 million opportunity

from economics to CUI, revenue-wise. And the largest scale one I'm seeing is a $30 million project, all based around how many megawatts the facility requires.

So, how big is the industry? It's a multi-billion-dollar opportunity, or a multi-billion-dollar target market. How much of that we can land I think is going to depend on getting this out to market as soon as we can and with the right partners, which I think we have. But the multi-billions is going to take -- that's over a number of years to do the installation. But on an annual basis, I think we've got in the early years a few million dollars in revenue up to $15 million to $20 million in revenue. And then from there, I think it will ramp quite high from there, provided it is adopted by the industry.

William J. Clough - CUI Global, Inc.
So in terms of Energy, I think we've been really upfront about this, we are introducing to the energy market a totally new and different way of monitoring calorific value, or quality of the gas, in the pipeline. The first proof of concept, if you will, was our winning of the Italian contract. The outgrowth of that is that we're now dealing with ENGIE, but I think to give you some idea of what's available, the DNV GL project, which you can look at their project -- we've given you a link to it on our website. It's called the Future Billing Methodology, and what it's designed to do is to allow European pipeline companies to inject low carbon methane, largely, but low carbon alternatives into the pipeline system. To do that economically and to bill accurately in a small pipeline like the UK would call for the deployment of as many as 45,000 gas metering devices. In France, that same system would deploy over 100,000 devices. Currently, there's only one device on the market that can do effectively what's needed, and that is our device. The gas chromatograph is wholly inadequate. It's too expensive; it's too high maintenance; it requires service gas. You cannot deploy thousands of gas chromatographs across any network. You just can't do it. So what has to happen is it has to be a device that does not use service gas, that is not $200,000, $300,000, or EUR 100,000 to deploy, and that can be deployed on a maintenance-free concept.

So again, I think if you look at the market, without even taking into account that, if you look at what's happening in Italy, if the deployment is the full 7,000 units that we expect, it will be around EUR 120 million to EUR 130 million project for us. That's money to us. It will be around a EUR 280 million project totally, and that is a large pipeline company in Europe, but frankly, ENGIE is bigger. Germany is about three-quarters of the size, and the Norwegian countries are about half the size combined. So again, if you look across Europe, you're looking at a significant opportunity for just the Snam Rete style deployment, which is taking the large industrial users and applying accurate billing to them, which creates a significant increase in revenues for these pipeline companies, because they begin actually billing the gas that they're delivering.

If you multiply that out to a residential customer base, like we're talking about with the UK and DNV GL, and if you look at DNV GL that certainly plans on taking that future billing methodology and has every intention of moving it across the entire feature of Western Europe, you're talking about billions of dollars in revenues. How much of that we capture, currently, there is no competing technology. There is no one else who can do what we do, so anything they're going to do in that regard is going to be ours.

The issue, of course is, as you identified in the beginning of your question, Bill, the adoption cycle is long. There's no doubt about it. You're dealing with the large companies, government and quasi-governmental agencies. They take long times to make decisions. On the other hand, the contracts that we've signed, as we did with the Italians, are huge contracts for a company our size. And I think as we can see with the recent press release with Snam Rete, where they're now borrowing EUR 310 million to complete these projects, they are quite intent on delivering biomethane and green gasses to their customers, and they're willing to pay a pretty steep price to do that, and I think we're in the forefront of that.

So I think, again, for me to quantify the opportunity is difficult, other than to say it's very, very large. I can say, though, that from our perspective, there currently is no other technology that can do what we can do, so whatever they do, they have to use us. Does that answer your question?

William John Nasgovitz - Heartland Advisors, Inc.
Thank you.

Daniel N. Ford - CUI Global, Inc. - CFO and COO of Energy Division
Bill, let me add to the ICE opportunity. I've got data that I can give to you now; I had to pull up the right information. So as background, data centers are a $22.8 billion market annually today, and that's with -- power management of those data centers is about $12.3 billion of that cost each year. In North America, data centers consume 25,000 megawatts annually, and that's increasing 10% to 15% per year. Really, it's increasing because of Internet of Things and just, really, the use of handheld devices continuing to increase data being used.

The ICE device can unlock 10% to 20% of power capacity, and so what we see in North America alone is a $700 million to $1.4 billion total addressable market. And then, currently, we're estimating the global total addressable market to be about five times the size of North America. So, given that ICE can reduce CapEx by 40% to 60% and increase efficiencies in power usage, and we have the exclusive rights to this device with VPS's software, we're in the leading position to capture that. So right now, we're just pushing to get it to market as quick as we can with our partners.

William John Nasgovitz - Heartland Advisors, Inc.
Have you publicly discussed your partners?

William J. Clough - CUI Global, Inc.
The only one we can name is Intel because they self-ideintified at the OCP. The other ones we have not been able to name due to NDAs. As soon as it goes to market, though, that should be publicly known and we can share that at that point.

William John Nasgovitz - Heartland Advisors, Inc.
Thank you.

Operator
Thank you. Our next question comes from the line of (inaudible) with Radiant. Your line is open.

Isuru Seneviratne – Radiant Value Management – Founder, Portfolio Manager
Good morning, and thanks for the update. Question on the new directive to replace flow computers. Does that apply across the board across Europe, or is it just an Italian thing? And if it does apply across the board, why are other utilities not moving on this?

William J. Clough - CUI Global, Inc.
No, it's just Italian, and I can't give you a really detailed answer on flow computers, because we don't do flow computers. But I know that's part of their project.

Isuru Seneviratne – Radiant Value Management
And in Europe, GRTgaz through the ENGIE connection, what's the status on their movement towards getting GasPT units deployed on that?

William J. Clough - CUI Global, Inc.
Were in discussions with them right now to put some field trial units in with GRTgaz. We had arranged to do that, actually, through ENGIE, but they subsequently separated. The government recently separated them and made two different companies out of them, so GRTgaz is no longer a part of ENGIE. So because of that, we had to do a different application process with this new group within GRTgaz, but we expect to move forward. They won't need to do any more testing; they'll accept the testing that the Italians did, just as ENGIE did. But we do have to go through a different application process, because they're no longer a part of ENGIE.

Isuru Seneviratne – Radiant Value Management
Got it, so do you have a sense on the timeline for those bids, or what's the --

William J. Clough - CUI Global, Inc.
Well, no, it's not a bid process. We'll certainly have something in the ground this year; I just don't know when.

Isuru Seneviratne – Radiant Value Management
Another question in terms of I guess longer-running projects that have the potential, you worked with some LNG customers on the VE probe for a couple of years now, maybe a bit more than that from some instances. What's the uptake? Are anybody showing interest, and if so, why, or if not, why?

William J. Clough - CUI Global, Inc.
Yes, we have significant interest. We're still delivering product into Gorgon, for example, down in Australia. We have had a number of inquiries now from some very large producers and transporters. As a result of the test that we did at Southwest Research, we had, to be frank with you, some of the top -- in fact, four of the top five gas producers and transporters in the world were present at that Southwest Research facility when the tests were conducted, and we have in fact seen a significant amount of interest. It just has not yet resulted in purchase orders. Again, these are big companies that they take time to move. There's no two ways about it.

And the other thing, that when you're dealing with LNG terminals especially, for example in Gorgon, there's a number of different projects we're involved in, but these projects generally have to occur when they have scheduled plant shutdowns, and those shutdowns occur, generally speaking, on an annual basis. So for example, we might be dealing with projects in Gorgon now that won't be seen to come to fruition until 2018, when the plant shutdown occurs, the scheduled plant shutdown in 2018 -- or for that matter, in 2019, because they do plan several years ahead. But again, there is definitely significant interest.

Daniel N. Ford - CUI Global, Inc.
Along those lines, we're in early stages with companies that are looking to build new facilities as well, from LNG facilities to ethylene plants. But those are, you know, from the time that they start planning those, it's a four- to five-year process before they start construction, if they do start construction. So we're in front of those opportunities. That's a big reason why we opened up our Houston office in 2015 is to get in front of those guys, and we are actively doing that. But you know, it's not a matter of jumping in and getting right to the head of the line. It's we've got to be part of a CapEx program

and project, whether it's a new build or a shutdown and installation for upgrades. So the team is in front of very major pipelines and producers for those purposes.

Operator
Thank you. (Operator Instructions) Our next question comes from the line of Mike Breard with Hodges Capital. Your line is open.

Mike Breard - Hodges Capital
In South Texas, you sold a product to I believe it was an ethylene plant last fall, and their six-month test period ought to be over with. Have you heard anything more from them?

William J. Clough - CUI Global, Inc.
We have not, and actually, we've made soft inquiries. You're absolutely right; they were supposed to tell us something end of June, first of July. We have not. I guess the best thing I can tell you is that no news is good news. If there has been a problem with it, I know we would have heard. We have simply not gotten anything formal back from them. We have done some back channel, in essence, inquiries. We know that the product has been installed; we know that it's done very well. But again, it's the kind of customer, as you might imagine, that's very large, and they're going to talk to us when they want to talk to us. But our understanding is that it's worked and worked well; we just have not heard anything back from them yet.

We are, though, just as an aside, we are pursuing other ethylene opportunities. We have a number of different opportunities in that regard and have some projects that we think we'll be announcing in the next little while. So we've had some good success getting in front of people.

Mike Breard - Hodges Capital
Okay, thank you.

Operator
Thank you, and I'm showing no further questions. At this time, I'd like to turn the call back to Mr. Clough for closing remarks.

William J. Clough - CUI Global, Inc.
Thank you, Kaleigh. In conclusion, I just want to thank everybody for attending the conference this morning. As always, Dan and I are available for follow-up. If you would like to talk to us, please contact us through Sanjay at the scheduled time to speak. Thank you again, and I look forward to speaking to all of you or any of you that attend our upcoming conference presentation, and obviously, in our conference call next quarter. Thank you for your continued support, and that should end the call, Kaleigh.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone have a wonderful day.