CUI Global, Inc. Q3 2017 Earnings Conference Call

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C: Glenn Mattson – Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research
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C: Jon Fisher – Dougherty & Company LLC, Research Division - Senior Research Analyst of Industrials
C: Mike Wallace – White Pine Capital
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Operator

Good day, ladies and gentlemen and welcome to CUI Global's Third Quarter 2017 Results Conference Call. (Operator Instructions). I'd now like to introduce your host for today's conference, Mr. Sanjay Hurry, Investor Relations. Sir, please go ahead.

Sanjay M. Hurry -

Thank you, Liz. Good morning and welcome to CUI Global's Third 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 & Presentations page on the Investor Relations section of the CUI Global website. With us on the call this morning 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 third quarter and to provide you with management's perspective for the balance of the year.

Following management's remarks, the call will be opened to question and answers. A telephonic replay of this call will be available until November 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 fluctuation in future operating results due to a number of economic, competitive and other factors, including, among other things, its reliance on third-party manufacturers 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 the 8th Annual Craig-Hallum Alpha Select Conference in New York City on November 16. To schedule a one-on-one at the conference, please contact your Craig-Hallum representative or call my office at 212-838-3777.

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

William J. Clough *CUI Global, Inc. - CEO*
Thank you, Sanjay. Good morning everyone and thank you for joining us on our fiscal third quarter 2017 results conference call. We reported third quarter results this morning in line with our preliminary financial results for the quarter as announced on October 16. As part of that announcement, we launched a public offering of common stock that closed on October 23 and generated net proceeds of approximately $19 million to CUI Global.

Before delving into our results for the third quarter, I'd like to address certain aspects regarding the capital raise. In the spring of 2016, we were awarded the contract for a re-metering project in Italy for Snam Rete Gas. The project calls for the deployment of 3,300 of our GasPT units over 3 years. In February 2016, we received an initial purchasing order of 400 GasPT units to be delivered at a rate of 50 per month. We delivered the 400 units by October of that year and anticipated the receipt of a second purchase order for the remaining 2,900 units to be delivered at a rate of 100 units per month. Delivering GasPT units at 50 units per month gave us an improved net loss of $0.02 per share and positive operating cash flow of approximately $1.5 million for the third quarter of 2016. At that time the electronics business had just started to move into an upcycle, giving us some lift in our Power segment, which was approximately two-thirds of our consolidated results. At 50 GasPT units a month, we were almost breakeven on a net income basis and we are already generating cash from operations. 100 units per month would make the Energy segment profitable. However, as most of you know, in October 2016, the regulatory body in Italy suspended Snam Rete's re-metering project due to a tariff issue completely unrelated to our GasPT.

Absent a second purchase order, cash burn increased because we continued to execute on our growth strategy to expand the opportunity set for our energy products. To close the gap until the order flow for GasPT picks up, we evaluated sources of capital, including the sale and leaseback of our headquarters in Oregon and an equity raise. In the end, we determined that the most efficient, logical and economical avenue for us was an equity raise. The capital raise gives us a bridge to profitability to be derived from a second Snam Rete purchase order, incremental GasPT opportunities from ENGIE and/or others and continued growth in our Power segment. The raise also allowed us to pay down our line of credit and significantly strengthen our balance sheet.

Our distribution partner Socrate has resumed deployment of our GasPTs in Italy and we expect they will work down the 350 units in inventory by the end of the year, after which Snam is expected to place a second purchase order.

Now, let me briefly review the results of the third quarter before turning the call over to Dan Ford, our Chief Financial Officer for a more detailed review. I'll conclude the call with an update on our opportunity set as we approach 2018. Our financial results for the third quarter reflect continued year-over-year growth in our Power and Electromechanical segment and the timing of orders in our Energy segment that masks a substantial expansion in business development activity over the prior year. Revenue and EBITDA were also negatively affected by Hurricane Harvey, which shuttered our facility in Houston for much of September. I'll start with the performance of the Power segment. Revenue in our Power and Electromechanical segment increased approximately 3% year-over-year and decreased about 8% sequentially. Regarding our distribution channel, we continued to see strong backlog and point-of-sale results from all of our channel partners. Our direct OEM business remained strong with design activity continuing with a broad mix across our product offering. On a sequential basis, we experienced seasonality inherent in the electronics industry with inventory build-ups peaking in the second quarter and being worked down over the balance of the year. Power segment backlog was a robust $18.1 million at quarter end.

In our Energy segment, revenue declined 28% year-over-year, reflecting the suspension of the Italian project and a broader base of opportunities that has yet to convert to contracts. We know our GasPT is a game changer in the marketplace, a faster, more accurate and much less costly alternative to legacy and more costly gas chromatographs. We also know these prospective customers do not move quickly, even for game-changing technologies such as ours. They're methodical in their decision-making process, but they are also able to commit in a very substantial way as Snam Rete did. We have been moving to replicate that success with other gas operators.

The Energy segment's performance was also impacted by Hurricane Harvey. Due to the flooding and other damage, we had to suspend the work on some of our integration projects and some customers could not accept delivery in the quarter. Our facility was up and running again in a matter of weeks. At quarter-end energy backlog stood at $13.7 million.

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

Daniel N. Ford ***CUI Global, Inc. - CFO***
Thank you, Bill. I'll start with a review of our financial results for the third quarter of 2017 and recap our

balance sheet highlights in light of our recent public offering.

Total revenues were $21.8 million, a decrease of 6% from $23.3 million in the third quarter of 2016, reflecting a $500,000 increase in revenues from the Power and Electromechanical segment offset by $2 million in lower revenue in our Energy segment. Q3 Power and Electromechanical segment revenues were $16.7 million, a 3% increase year-over-year. On a sequential basis, Power and Electromechanical segment revenues decreased 8%, reflecting normal seasonality in the industry. The electronics market remains in an upcycle, and the broader base of business we have established over the past several years with new distribution partners, new design wins and new product introductions gives us a strong foundation for long-term growth within this segment.

In addition, we have seen an investment from the distribution partners in inventory due to an industry wide demand for more inventory ahead of what the industry projects to be increased lead time schedules. Today, our lead times [have not flipped] for our product lines. As Bill noted, our direct OEM business remains strong and we are seeing growth areas to those customers, particularly through our DC to DC and power adapter lines.

Energy segment revenues were $5.1 million, a decrease of 28% year-on-year, due to the timing of customer project delivery schedules, the halt of deliveries of our GasPT units to Snam Rete in Italy, and the impact and delays associated with Hurricane Harvey. Consolidated backlog was $31.8 million at quarter end, comprised of $18.1 million for the Power and Electromechanical segment that is flat with last year and $13.7 million for the Energy segment, compared to $13.4 million a year ago. As a reminder, energy backlog this year does not include any GasPTs for the Italian project. Rather the increase in Energy's backlog is attributable to integration orders at both our U.K. and Houston facilities.

Q3 consolidated cost of revenues as a percentage of revenue increased to 66% from 63% last year. For the nine months ended September 30, the consolidated cost of revenues as a percentage of revenue increased to 66% from 62% in the prior year comparable period. This percentage varies based upon the product and project mix within both of our business segments as well as contract labor costs within our Energy segment and foreign exchange rates.

During Q3, the Power and Electromechanical segment cost of revenue as a percentage of revenue was 66% as compared to 65% in the prior year third quarter. In our Energy segment, cost of revenues as a percentage of revenue for the third quarter of 2017 was 66% compared to 60% in the prior year period. For nine months ended September 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 nine months ended September 30, the Energy segment cost of revenues as a percentage of revenue was 65% versus 56% for the nine months ended 2016. The Power and Electromechanical segment remained generally consistent for both three and nine months ended with the changes attributable primarily to product mix. The increase in the cost of revenues as a percentage of revenue for the Energy segment during the three and nine months ended September 30 is the result of less favorable product mix due to the aforementioned temporary halt of deliveries to our customer in Italy of higher margin technology-based products.

Consolidated gross profit in the third quarter was $7.4 million for a 34% margin versus $8.6 million or a 37% margin in the prior year. For the third quarter, our Power and Electromechanical and Energy segments both generated gross profit margins of 34%. This compares to the 36% for the Power and Electromechanical segment and 40% for the Energy segment in the year ago period.

For the nine months ended September 30, consolidated gross profit was $21.3 million for a 34% margin compared to $25.8 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. Energy segment generated gross profit margins of 35% compared to 44% last year.

We will remain focused on improving margins within our Power segment through increasing efficiencies and controlling variable costs at our Canadian manufacturing facility and through continued new product introductions to the Power and Electromechanical marketplace. Through September 30, CUI has introduced more than 900 new products in this segment. Our 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 third quarter and year-to-date, our Energy segment revenue was more heavily weighted to integration work. We expect margins to improve in our Energy segment upon resumption of GasPT deliveries to the project in Italy and as other GasPT and VE projects begin.

During three and nine months ended September 30, 2017, SG&A was generally flat and $0.8 million lower respectively, compared to the prior year comparative periods. The decrease in the nine month period of $0.8 million was due to severance costs incurred in the first nine months of 2016 and in Power and Electromechanical segment for the transition of the R&D team to CUI-Canada and for various positions with the Energy segment. In addition, the company began implementing various cost-saving measures in Q2 2017, which provided some benefits in Q2 and Q3 and are expected to further improve our SG&A going forward. These benefits are partially offset by a $0.2 million increase in advertising costs within the Energy segment during the nine months ended September 30.

SG&A, as a percentage of revenue increased slightly to 38% from 35% of total revenue during the three-month period ended September 30, 2017 and increased slightly to 41% from 39% for the nine month period. Both percentage increases are primarily attributable to the decrease in revenues as compared to the prior years as discussed previously.

EBITDA loss for Q3 was $1.2 million compared to EBITDA of $0.1 million last year. For the nine months ended September 30, EBITDA loss was $5.4 million compared to an EBITDA loss of $2.1 million in the same period last year.

Net loss for Q3 was $1.9 million or $0.09 per share compared to a net loss of $0.5 million or $0.02 per share last year. For the nine months ended September 30, net loss was $7.3 million or $0.35 per share, compared to a net loss of $4.7 million or $0.22 per share in the same period last year. Cash and cash equivalents stood at $0.8 million at September 30, 2017, a decrease of $3.9 million from December 31, 2016. On October 23, 2017, we closed on an underwritten public offering of approximately 7.4 million shares at an offering price of $2.80 per share, including approximately 964,000 shares to cover the underwriters' over-allotments. A portion of the proceeds were utilized to pay down the outstanding balance on our line of credit.

Finally with funds raised from the public offering, the imperative to access other sources of capital has moderated. The sale and leaseback of our Oregon facility remains a fiscally prudent option, but one in which we now have the latitude to negotiate from a position of strength. This concludes my prepared remarks. I will now turn the call back to Bill.

William J. Clough *CUI Global, Inc. - CEO*
Thank you, Dan. As we awaited the resumption of the Italian project, we built demand for our energy products, especially our GasPT across a broader base of prospective customers and geographies so much so that Snam Rete is today but one of many opportunities ahead of us. From ENGIE and the U.K.'s Future Billing Methodology Project with DNV-GL to fiscal monitoring in North America and process control with a global leader in the gas turbine power generation market, each is a testament to the product set that is unmatched in the marketplace.

I will focus the balance in my prepared remarks on those opportunities likely to positively affect our financial performance in the near term across both of our business segments. Starting with our Energy segment and Snam Rete, the timing of its second purchase order will be driven by the pace of deployment of the balance of the initial 400 GasPT units. What we know is that Snam Rete is installing the units today and has committed to moving forward with GasPT as part of their re-metering project. For those new to the CUI Global story, I'll point out that our 3,300 unit contract is fully funded and Snam Rete reaffirmed its commitment to the re-metering project as part of a EUR 310 million loan it secured over the summer to fund part of its EUR 600 million capital infrastructure plan. Our contract covers the 3,300 largest Snam Rete offtakes. But Snam Rete has a total of nearly 7,000 offtakes on which our GasPT could be ultimately deployed.

Staying in Europe, we submitted a proposal for 1,000 GasPT units to Endel, ENGIE's integration arm, for use in their new biomethane-to-grid skid. This single source tender is closed and ENGIE intends to move forward with the build-out of biomethane terminals next year.

We also continued to progress one of our largest opportunities for the GasPT solution, the Future Billing Methodology, or FBM, project in the U.K. The U.K.'s regulatory agency OFGEM recently approved the Stage 2 Gate Report for the FBM, moving the project ahead to phase 2, while confirming the use of our GasPT as the selected CV (calorific value) analyzer. This positions us to secure a significant research and development contract to redesign our GasPT into a deployable product for this project and develop an implementation format for the rollout of the redesigned solution to the U.K. gas network's 23 million users. To remind you, this could lead to the deployment of as many as 45,000 GasPT units within the U.K. I should add that ENGIE is closely following the U.K.'s FBM project with an eye towards replicating it in France with an initial deployment of as many as 100,000 units. In North America, we are moving to replicate GasPT success and the fiscal monitoring solution at Snam Rete with gas operators in this geography. We are delivering field trial units to a gas pipeline company based in Canada that will initiate a 45 to 60-day testing period. Upon conclusion of this trial period, we expect our units to receive certification by Measurement de Canada, which will then pave the way for negotiations on a Snam Rete-like deployment with this operator. This template is being replicated with other gas industry participants in different geographies that offer incremental sales opportunities for the GasPT.

Turning to our VE Technology, we are seeing demand build for our sampling curves and systems across a broad array of applications from thermal wells to trace element detection. In several instances, we have been written into the new specs while in others we are now a preferred vendor. This is a nascent opportunity for us and we are seeding the market with customers with the ability to scale their orders as their confidence in our technology builds. In that vein, we were recently informed that we will soon receive a follow-on order for our VE sampling system for a second ethylene plant for delivery in the first quarter. This bodes well for future orders with this provider across all of their other plants.

Process control is another application suited to our GasPT and to that end, we have been working with one of the world's largest gas fired turbine manufacturers to certify the GasPT for its turbine. The manufacturer has completed a total of 5,500 hours, out of an 8,000 hour testing period which we now expect to conclude by year-end. Once complete, they will put gas -- the CUI Global on their preferred vendor list and will certify GasPT as a standardized device to use for process control in lieu of a gas chromatograph. Certification enables us to pursue the retrofit market produced turbines and to be included on new turbine sales.

Switching gears from energy products now to integration projects, we are seeing increased activity in Houston because of Hurricane Harvey. We are also starting to benefit from our growing reputation in North America for project excellence, reliable performance and quality engineering. This reputation and our results are translating to more work, including the addition of two new leading energy producers to our client list already in the fourth quarter. We are currently moving to a new much larger facility that allows for crane access so that we can take on much bigger projects, including those to repair the damage done in the gas network from Hurricane Harvey. As an aside, we will be hosting our upcoming annual meeting of shareholders at the new facility in Houston, so I encourage everyone to join us there on December 1.

Turning to our Power and Electromechanical segment. During October we received a substantial order for approximately 1,000 ICE Switches to be delivered in the first quarter of 2018. This order reaffirmed our belief that the ICE technology is a revolutionary approach to data center power utilization and that this order portends for a faster roll-out than previously anticipated. ICE Switch is one half of the ICE solution. We expect the ICE Block portion of the technology to receive UL and TUV certification by year-end. ICE technology revenue opportunities are supplemental to the continued strength in our core direct OEM business and distribution channel business.

In conclusion, our capital raise enabled us to replenish the balance sheet and move towards profitability without losing a step in executing on our growth strategy. We've expanded our opportunity set beyond Snam Rete and across both our segments grounded in our marketing-changing technologies and growing market adoption. It has taken longer than anticipated, but we remain steadfast in our pursuit of greater shareholder value promised by our unique technology portfolio.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question comes from the line of Eric Stine with Craig-Hallum.

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

I just wanted to start with Snam Rete. Obviously the deployments have started again. Any thoughts on or any color you can provide on how many of the remaining 350 have been installed? And then also, I mean, is there a way we should think about how many can be done per month, just trying to get at the chances that it is done by the end of the year, and also timing of that potential follow-on?

William J. Clough ***CUI Global, Inc. - CEO***

I am actually in Italy right now attending a Shippers' Day event with Snam and they're just gearing up. I mean, frankly, it would be a guess for me to say what they will be doing as they get going. They've just started out. They've -- I think they've taken a lot of 25 or 30, but I'm not sure how many of those have been installed. But I know they are starting to move forward with installations. I think, give me another 30 days, when I start to see how they roll out the second delivery and we will start to see how they're moving forward. But I think that -- it's not Snam that's doing it, it's a third-party contractor. They are paid by the installation. So they have every incentive to install quicker rather than slower. I will say that though -- this Shippers' Day is a big deal for them. It's their 75th anniversary, 75 years of business, and the keynote address is given by their Chairman, Carlo Malacarne. And he started off with 3 bullet points about how they're committed to investing in decarbonizing the grid and moving towards a biomethane solution. So I think, for us at least I think it's going to be a long and very profitable relationship with Snam Rete. They have got, according to him, about $4.75 billion to invest in infrastructure over the next 3 years. So they're quite committed to building out metering and the biomethane, which of course are our two high points. So again with that in mind, as it develops, I'll certainly let people know how the rollout is coming.

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

And I know timing of that follow-on, that's a little uncertain, but it does sound like you've got a high level confidence in having the remaining 350 in place by the end of the year. Is that fair?

William J. Clough ***CUI Global, Inc. - CEO***
Yes, that's very true. I have seen nothing to tell me different right now.

Eric Stine ***Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst***
Interested in the commentary on the ethylene opportunity, the second order. Just to confirm, you said in the first quarter you anticipate an order for a second plant. And then, I mean it was key to get through the first one. Any thoughts on what this customer is thinking in terms of the timing on that second plant? And I mean is it still something where you think they could move across their 50-plus plants with this technology?

William J. Clough ***CUI Global, Inc. - CEO***
I think the good news -- the bad news is they haven't told us anything, although they're not obligated. I think we've talked about this. They are not obligated to tell us anything. They're a very large customer. They had agreed to give us what their results were and they just haven't done that yet. We pressed them, but we don't have really any leverage over them. But the fact that they've reordered to now do a second plant tells me that they're obviously having pretty good results. These plants are huge. They are plants that shut down, generally speaking, once or twice a year for retrofit of various different elements within the plant. And this one, we've been told, will be shutting down in the first quarter. So we're putting together a set of probes for that plant to be installed during that shutdown. I don't have any idea as to when or if they're going to roll them out across their entire fleet of plants. It is over 50 plants. But again I think the fact that we've got a follow-up order tells me that they are -- that they are seeing good results from what they've got.

Eric Stine ***Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst***
Good to hear on that. And last one, just on the OpEx side. I mean clearly you -- little downtick this quarter, you didn't get the full impact of some of the steps you've taken and I know it's a key objective. How should we think about that, I guess fourth quarter, but more importantly kind of a sustainable level in 2018?

William J. Clough ***CUI Global, Inc. - CEO***
Correct. So, Dan do you want to...

Daniel N. Ford ***CUI Global, Inc. - CFO***
Yes. I mean, so Q3 to Q3, it's -- not a whole lot changed, year-over-year comparison. But from Q1 and Q2 run rates were down considerably. We're down $500,000 from Q2 and about $350,000 from Q1. So those cost downs have started taking -- making an effect on the company and they're going to continue to keep improving the results in that direction. I think where we're at for Q4 is probably going to be consistent with Q3 from a SG&A standpoint and from D&A and R&D as well. So I think those numbers are going to be fairly consistent through Q4.

Eric Stine ***Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst***
And then -- I mean 2018, is it something where -- because you did have some one-time costs in this quarter that you called out. Is it something where you think there could be a little bit lower levels as you look to '18?

Daniel N. Ford ***CUI Global, Inc. - CFO***
There could be some improvements. There could be some improvements. That's going to depend on how the things shape up for the next couple months. I think that that’s a safe number to be, yes.

Operator
Our next question comes the line of Rob Brown with Lake Street Capital.

Robert Brown ***Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst***
Just wanted a follow up on your -- first on your ENGIE comment. You talked about some biogas skids. What's sort of the opportunity set in ENGIE and how is that developing?

William J. Clough ***CUI Global, Inc. - CEO***
Yes, they're committed to rolling out 1,000 biomethane-to-grid skids over the next 2 to 3 years. That's their proposal. They want to go very strong into the biomethane market. And we -- in each of those skids there are -- their plan before we got involved was for 2 gas chromatographs. One to measure calorific value or quality and one to measure odorization. The one to measure odorization, we don't do that. So that -- that will remain. But they -- what they've opted to do is replace the quality analyzer with our analyzer. It was a single source tender that they've put out. We were the only ones in the spec for that portion of the skid. So we expect to be put into that portion of the skid. But we don't have any outline as to when they're going to proceed, other than the contract closed June 24. Generally speaking, European Union contracts take a much -- somewhere between 90 and 120 days after the tender closes. So that would be sometime before the end of the year. It close -- let's just assuming that it closed June 24, which it did. And I think they are seeing a rollout sometime in 2018. But again, we'll know more about that build schedule when they actually release the contract and we actually go into negotiations and that hasn't happened yet.

Robert Brown ***Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst***
That's good color. And then the gas turbine opportunity, I think you said by year end the customer will have the hours in place. Do you have a sense as to how that rolls out? What are sort of the channels to market and timing of order flow into '18?

William J. Clough ***CUI Global, Inc. - CEO***
Yes, we are actually a little disappointed about that. It was -- I think if you recall from previous calls, we had assumed and hoped that this would be done by the end of October. We began (technical difficulty) 8,000 hours is actually 333 days. So we would have expected it to have happened [by the end of October]. What happened ultimately which is to show how hiccups going to occur on these things, the customer ended up running a non-compliant gas through the device for a period of about 1,000 hours,

almost 1,500, I guess at the end of the day. They saw -- as we would expect, they saw some deviation. They called our techs out there. They ended up going out to meet with them in Italy for about a week and convinced them that in fact they had been running wrong gas through the device for this period of time. Due to that rather than starting the test over which we anticipate not doing, they simply eliminated the roughly 1,500 hours that had been tested this inappropriate gas and wanted to put us back to 5,000 hours of completed testing. We’ve now continued forward and we've now done another around 500 or 800 hours. So we're now down to about I think somewhere around 2,000 -- 2,200 hours to go. So that's why I'm still convinced it will be by the end of the year. They have not seen a single hiccup other than when they put out of compliant gas through that. And even then it wasn't a significant change, it's just the device drifted more than they wanted it to. But again, I think I'm quite confident that at the end of the 8,000 hours, the machine will have performed flawlessly and we will see a joint press release where we will become a vendor. At that point, they'll ask us for an initial call up purchase order of between 20 and 30 units, which I think covers new sales for some period of time. And we will be going aggressively after the retrofit market, which is as many as 26,000, 27,000 machines out there in the marketplace that we feel we can attack. And these are machines that we can run much more efficiently, much more effectively and I think we can reduce fuel usage by somewhere between 4% and 8%. So that's going to be a huge savings for those operators. But we can't do that until we have their certification. So that kind of -- I think -- I hope that kind of explains where we are at.

Operator
Our next question comes from the line of Jon Fisher with Dougherty.

Jon Fisher ***Dougherty & Company LLC, Research Division - Senior Research Analyst of Industrials***
I wanted to go back on the SG&A comment. As you explore some of these newer opportunities on the energy side looking out to next year, I guess what should we expect SG&A spend to look like next year as you pursue and develop some of these opportunities? I mean can you hold it flat to down, or should we expect some sort of meaningful increase?

Daniel N. Ford ***CUI Global, Inc. - CFO***
No, we believe we can hold it flat to down. And I would -- for modeling purposes, I would say flat at this stage given the cuts we've already done this year. And the reason I can firmly say that is the team that we have in place targeting these large opportunities is already managing those projects across North America, Asia and Europe. So they've got the bandwidth to keep doing that. It's the same team that supported the business at Snam Rete, ENGIE and National Grid and so on. So I don't see that group needing to significantly change in order to manage that. Actually it isn't expected to move to support those opportunities. And similarly with the ICE technology, it's set up similarly to capitalize on the infrastructure and teams we already have in place from the power side also.

Jon Fisher ***Dougherty & Company LLC, Research Division - Senior Research Analyst of Industrials***
And then looking at the power and electrical segment, each of the last 2 years we've seen a pretty significant seasonal step down in revenues from that segment. Would you expect a similar significant step down this year? Or as demand and the strong backlog will that moderate the seasonal sequential

roll off in revenues there?

Daniel N. Ford ***CUI Global, Inc. - CFO***
Seasonality in Q4 is an ongoing event. That's going to be a consistent event to layer in. Q4 and Q1 always have that impact. Q4 -- companies build up inventories during Q2 and Q3 for production and delivery of their own products during the fourth quarter typically and then Q1 is always a little bit lighter following the holiday lag and then also the impact from Chinese New Year. So those impacts we always reflect in our own planning and I would still expect the same for Q4 this year also.

Jon Fisher ***Dougherty & Company LLC, Research Division - Senior Research Analyst of Industrials***
And then looking up to next year on power and electrical, are you from a demand standpoint given the backlogs and the demand that you're experiencing now, do you think that's sustainable through the next year? Or are you expecting some type of slowdown in the demand environment next year?

Daniel N. Ford ***CUI Global, Inc. - CFO***
Based on what we are seeing right now from a design win standpoint, from channel sell-through and distribution, and what our direct -- already customers in production are doing, I wouldn't expect a slowdown. Also based on what the industry is forecasting. The industry is really actually very bullish. The one thing they are doing though is building up inventory levels to some degree ahead of expected shortages for certain components. So that's the only thing that we are watching to keep an eye on to see how that impacts our own production ability. To-date we have not had any delays or extended lead times of our products yet. But that's something that we're going to continue to watch that that will impact how the industry's sales flow. But right now we're very up on what the line is going to be from continuing this pattern into 2018.

Operator
(Operator Instructions) Next question comes from Glenn Mattson with Ladenburg Thalmann.

Glenn Mattson ***Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research***
I missed what you said on the ICE Block that there would be UL certification by year end. But what are you guys expecting, how quick can you turn that into actual orders as you look into '18?

William J. Clough ***CUI Global, Inc. - CEO***
We were -- if you were to ask me this just a little while ago, I'd have said sometime in mid '18, but quite surprisingly, and I think you probably saw the press release, quite surprisingly we almost immediately received an order for 1,000 -- almost 1,000 ICE Switches from one of our large Asian channel partners right after the ICE Switch received certification. Now there is -- they could buy an ICE Switch to do any -- I am sorry, they could buy a switch to do any number of things. An ICE Switch though is needed to operate the ICE Block technology. So I have to assume that as soon we have certification on that ICE Block the same Asian customer is going to buy a similar number of ICE Blocks. Obviously the MSRP is much higher on the ICE Block. The ICE Switch is between $700 and $1,000. The ICE Block is between $4,500 and $5,500. So again a much bigger purchase. And it indicates to me at least that certainly this customer has

been very satisfied with the results and is rolling out the set of power controls across a large part of their system. So it's hard to say. But I would still take a conservative approach and say that we don't believe there will be significant income -- significant revenues from the ICE Block until sometime second, maybe even in the third quarter of 2018. But on the other hand, like I said, this development with ICE Switch is quite surprising and does show how people are looking to this.

Glenn Mattson ***Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research***
And is there an idea -- do you know what the Energy segment would have done without the Hurricane disruptions? How big of an impact was that?

Daniel N. Ford ***CUI Global, Inc. - CFO***
It was probably between $0.5 million and $1 million in revenue. And then it was also an impact on bookings during the period as well. So it was an across the board impact.

Glenn Mattson ***Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research***
Okay. And then last -- go ahead.

William J. Clough ***CUI Global, Inc. - CEO***
The upside is, I would just add that we have now moved into our new facilities. We've had three major customers come through to audit that facility and in each case because of the size of the new facility and their ability to move the projects and they need cranes, all 3 of those have offered us projects that we would not otherwise have gotten. And in 2 of those 3 cases, those projects are repair projects for damage done by the hurricane. So if there is a silver lining to this, there is -- we are already seeing projects develop that would not have developed without the hurricane. So I think in the future, it may be a positive when it comes to revenues and earnings. But again, looking backwards it was definitely a negative.

Glenn Mattson ***Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research***
Lastly on the GasPT. Of the 400 units that have been shipped, where do those reside currently, does Snam Rete have them?

William J. Clough ***CUI Global, Inc. - CEO***
50 of them have been installed -- approximately 50 of them have been installed. About, I believe 25 or 30 more have been delivered to the third party installer and then the other 300-325 or something around that are at Socrate, at our distributor's storage facility in Milan.

Glenn Mattson ***Ladenburg Thalmann & Co. Inc., Research Division - VP of Equity Research***
And I just wonder about the pace of deployment. If they are just starting now and it's mid-November, and I guess last year when they were -- when the project was in full steam in the middle of the year, they only installed 50 over a span of two quarters. I'm just kind of thinking about how far this bleeds into 2018 before you start to see a new order. Maybe some data on how long of a lead-time they need to give you for you to produce order -- produce the units and deliver them?

William J. Clough ***CUI Global, Inc. - CEO***
Yes, I think we talked about that earlier, but just to recap. They never got the full steam. They were stopped after installing about 50 units. In other words, they were never on a full steam. They stopped. They took delivery on all 400, because they issued a purchase order and they had no right not to take it. So the 400 were delivered. We got paid for the 400. But they were stopped short of ever getting up to full speed. So they've never been up to full speed. What I talked about earlier is we've seen this first group of 25 or 30 delivered to them. I don't know how fast they're installing them and I probably won't know until I see the second order come through or the second demand come through. But the third-party vendor who is doing the installation is paid on a per installation basis. So I know that they have every incentive to move forward as quickly as possible. I just don't know at this point what that pace is. But we have -- at this point, we believe that they will be issuing a purchase order sometimes towards the end of the year. And the purchase order, the lead time just so you know, as they intend to issue a purchase order when they are down to 100 or less in inventory. So they actually want to -- have to get through another 220, 230 units and then they will order. That's what they told us.

Operator
We have a follow-up question from the line of Jon Fischer.

Jon Fisher ***Dougherty & Company LLC, Research Division - Senior Research Analyst of Industrials***
Just following up on the hurricane impact. The delayed orders or delayed business from customers that were impacted by the hurricanes, what kind of lingering impact in the fourth quarter, maybe even into next year should we expect? Or were the delays such that the turnaround time is pretty quickly and they can get back to business with you right in the fourth quarter?

William J. Clough ***CUI Global, Inc. - CEO***
They are coming back. Go ahead, Dan.

Daniel N. Ford ***CUI Global, Inc. - CFO***
They are already -- they have been coming back. Houston is a resilient community. I mean they were already doing conferences, I think the very week after the hurricanes at their convention center, a major gas conference. So they are resilient. From taking from what is done, it slowed -- it slowed our ability to do integration work during about a months' period as well as to get the customers' schedules for when they were taking deliveries. So it was really an impact for Q3 primarily. They've already picked back up. We've seen an increase in ordering already through October. We've also seen -- one of the other things that impacted was there were several projects that the customers had us put ahead of integration which was fixing things that have gotten drowned during the flooding. And so that delayed new integration works and had us go out and do some repair work for them to get them up and running with what they already had. So we think the primary impact of it was in the Q3 period and that it's finished. We're seeing opportunities with new projects coming on both from replacements and just continue to increase our work with them as we proven ourselves down there.

Operator
Our next question comes from the line of Mike Wallace with White Pine Capital.

Mike Wallace - *White Pine Capital*
Couple of questions. First on the ICE Block. What gives you confidence you're going to get the UL approval by year-end? And then a secondary question to that, can you give us some idea of the economics around the ICE Switch and Block combination?

William J. Clough *CUI Global, Inc. - CEO*
Yes, let me answer the -- I'll answer the UL and then I'll toss it to Dan for the economics. We're confident on the certification only because of what we hear from our technical people. The part that's the most difficult as I understand for the certification is the battery portion of it. It looks like we're moving with great progress through that. That's from our technical people. We have passed a couple of the first phases of the certification testing. The other issue that they're doing is some of the criteria having actually be rewritten. There is nothing really like what we're doing, it's not a battery backup as you know, it's really more of a hedging or leveraging the battery power. But again this is coming from our technical people. They feel that the things are moving forward efficiently and they're quite confident they're going to get it by year's end. But it comes from them, not from -- certainly not from UL or anyone there. But I think my technical people are pretty sharp on this and they're quite convinced. And as far as the economics are concerned, Dan do you want to take that?

Daniel N. Ford *CUI Global, Inc. - CFO*
Sure. What we're targeting is a mid-30%s gross margin on this, including fees to the software company, when we are up and running at full speed. And that's based on the price points that Bill mentioned earlier, $700 to $1,000 for the Switch and $4,500 to $5,500 for the ICE Block. And the pricing on those varies depending on the configurations and requirements there. That's the general economics there. The key though for the company on those two technologies is they're both being built at CUI Canada facility. And because of that that's going to continue to improve our efficiencies out of that facility, increase our turnover and further covering our overhead costs that go into having that factory in place. So it's going to have a real compounding improving effect on the whole organization.

Mike Wallace -
Is it one switch to one block, or can one switch control several blocks?

Daniel N. Ford *CUI Global, Inc. - CFO*
It's one to one. One switch per block and then the block can run without a switch, but the switch can do other things without the block. But it is -- each block requires a switch.

Mike Wallace -
And can you guys talk a little bit about the manufacturing plant, you mentioned just briefly there, for the ICE Block and Switch, but also for the GasPT device? As you look out into '18 any thoughts for any other issues that you still see that you're worried about?

William J. Clough ***CUI Global, Inc. - CEO***

No. I think from the GasPT -- from the GasPT perspective, there is really nothing exotic about the device. It has no exotic materials, it has no exotic pieces, it's there -- the long lead-time items really are machined parts that have to get done, but nothing that requires any unusual acquisition or procurement. We have -- to create efficiencies we have now begun producing the boxes for the GasPTi and the GasPT. The box device is not the device the Italians are using. We're creating those boxes in Houston because of efficiencies and costs it's much cheaper to produce frankly in the U.S. than it is in Europe or in the U.K. We are still producing the GasPTs in our U.K. facility. We've got a very nice, very efficient operation going now. We, as I mentioned, can produce and calibrate. It's approaching now 200, 250 a month if we need it. We have produced a backlog. So we're ready to move forward immediately on the Snam Rete order once we get it. And so again, I think we're quite confident that we have a real handle on production. It would be very easy to ramp up by simply adding more calibration units, which we can do quite quickly. They're not particularly expensive. They're about $60,000 a piece, so it's not a big CapEx expense. It's simply a -- something we go out and get. So again I think we're in pretty good shape. We are pretty happy with that. As far as ICE Block and ICE Switch, Dan do you want to talk a little bit about that?

Daniel N. Ford ***CUI Global, Inc. - CFO***

Sure. The key on that is really lead times on certain components, which we already have been planning around. And so the more insight we get from our customers about the volumes in this as well as they are going to have the better, we can plan ahead. But that's already being factored into the production plan and the procurement team's plans. So we're keeping an eye on that and managing with our vendor relationships also which we keep close.

Mike Wallace ***-***

Any unique parts in in Block or the Switch that concern you?

Daniel N. Ford ***CUI Global, Inc. - CFO***

They're not necessarily unique and inherently unique. It's got battery packs that we've got beginning to source from a company that we've worked with closely to get them exactly how we want the battery and then the battery pack itself put together. And then there is -- the other components though that goes into it, are all -- the components themselves are fairly standard. It's a matter of how they get put together and the software behind them and the design of the board itself. So nothing that is like a rare component or anything like that that's going to be an issue necessarily.

Mike Wallace ***-***

All your suppliers are ready to go?

Daniel N. Ford ***CUI Global, Inc. - CFO***

Yes. Most definitely.

Mike Wallace ***-***

How many GasPT devices do you have in inventory that you could ship -- start shipping immediately?

William J. Clough ***CUI Global, Inc. - CEO***
I think we've just under 200 and we will have...

Mike Wallace -
200 ready to go, okay.

William J. Clough ***CUI Global, Inc. - CEO***
Yes, ready to go. I think we're planning to have a total of 400 ready to go at the end of the year, so that we can ship. We can drop ship those immediately once there are orders.

Mike Wallace -
And then you rev-rec on shipment or an acceptance from the other side?

William J. Clough ***CUI Global, Inc. - CEO***
Yes, correct. But again understand that the last time they did this, they took 50 a month. This time they're intending to take 100 a month. So we wouldn't drop ship the whole. The purchase order would be for 400 or more, because that's their price break. But the shipments would be 100 a month.

Mike Wallace -
100 a month, okay. We've already flushed the cost through to produce those, I assume, right?

Daniel N. Ford ***CUI Global, Inc. - CFO***
Yes, the value is in inventory right now.

Mike Wallace -
And then the issue around this non-compliant gas, give us a little more color on that and how it was detected and...

William J. Clough ***CUI Global, Inc. - CEO***
They were running a gas through this, as I understand, that has had a very, very high CO2 content, a CO2 content that was out of spec for any -- what would be defined as natural gas. So it was not a natural gas, it was something else. Why they had it run through, I have no idea. How it happened, I have no idea. But what happened is we started getting reports from them of a drift. They were seeing a drift in the machine. So we tried various remote fixes and were unable to correct it. So I actually sent a technical team out there. They got out there. They were in the process of attempting to rewire, do some other things they thought might be the problem when they discovered, well, wait a minute, the gas that you're bringing through that's not one of the natural -- that's not a natural gas, number one. And secondly it's not one of the gases we're designed to test with. The Italians -- I never got an explanation as to how or why that happened, other than the fact that they admitted that it was in fact out of spec gas and that it was in fact not what would be considered a "natural gas". And that they agreed that during that time

period, the test results would not be counted at all. They would simply start at where that gas -- where they identified that gas problem occurring, which is at approximately 5,000 hours. It was the credit for the 5,000 hours and started to go again, which is exactly what they did. And like I said, I think we've done another 500 to 700 or 800 hours now. But again, I will tell you that my understanding from our Italian distributor is that they've been involved in testing procedures with the same customer where something like that has happened. Totally their fault, totally on their side and they have said, "Oh, well, start over again." We were quite adamant about the fact that we were not going to start over again. And we've been through so much of discussion any way. And they were cooperative. They admitted it was their issue and that it occurred on their side. And they opted to again give us credit for the 5,000 hours and start us where we had stopped. It's just I think an illustration from our perspective of how difficult it is to get certified on these natural gas operators' machines. Whether it'd be turbines, whether it'd be process control, whether it'd be pipelines, they are very, very slow to move, they're very, very particular and they're conservative. They don't -- they never make mistakes frankly at all and it's something you just have to work with and that's what we're doing now. We are at a point where we've got a lot of credibility ourselves. My engineers are quite respected because of what they've done in the industry. And I think that respect and that credibility allowed us to recover from that in a much faster and a more efficient way than we might otherwise have. But again, it has delayed the process.

Mike Wallace ***-***

How was it discovered though, Bill?

William J. Clough ***CUI Global, Inc. - CEO***

The techs came out. I mean, I don't know -- I don't know who was in particular. They went out there -- I don't know whether -- in other words, it was their tech or our tech. They indeed went out to...

Daniel N. Ford ***CUI Global, Inc. - CFO***

They signaled for that it was missing, that something was going wrong with the drift coming out of the GasPT device. So the GasPT's results were drifting farther than it should have.

William J. Clough ***CUI Global, Inc. - CEO***

Right. It was drifting farther than it should have. So we tried several fixes remotely, which we thought it might be some electronic problem, I mean some wiring problem, because we assumed obviously they were running the right gas through it. We sent a technical team out there, because I was concerned about what it was -- what was happening. They -- as I understand it from them, they were in the process of trying to figure out how they can rewire it to maybe effect of the remote nature of the power supply or the things they were looking at. And somebody either their technician or our technician said, wait a minute, this gas is not -- this is not a natural gas, what are you running through this, at which point everybody kind of looked at it and agreed. Somehow it had been -- it's running gas that was very, very high in CO_2. I mean, I'm talking like 40% or 50% CO_2, very high CO_2. And it was not an appropriate gas. It was not something that we would be expected to analyze.

Mike Wallace ***-***

So basically the PT device detected it?

William J. Clough ***CUI Global, Inc. - CEO***
Yes, exactly right.

Daniel N. Ford ***CUI Global, Inc. - CFO***
From the drift, correct.

Mike Wallace -
That's what you just said, because it's out of compliance and alarm bells went off , so you guys got technicians on it? Why'd it take so darn long?

William J. Clough ***CUI Global, Inc. - CEO***
Because first and foremost they didn't notify about it -- us about it for a period of time. And then when they did notify us, they -- obviously we tried to fix it remotely, because we assumed [they used the] right gas and have an electronic problem. By the time we got to the problem, we couldn't fix it remotely. Now I am sending people out there to get them out there and actually go and figure out what's going on. It's 1,000 hours and then actually you'll get 1,200 hours.

Mike Wallace -
Well, you detected it and fixed the problem, that's good. And there aren't real-time incidents of...

William J. Clough ***CUI Global, Inc. - CEO***
The silver lining is -- the silver lining is we got it fixed and we got it identified. The cloud is it did set us back to 1,000 hours.

Operator
And we have a question from the line of Jeff Bernstein with Cowen & Company.

Jeff Bernstein -
Just a couple. Can you give us an update on what's going on with that gas odorization technology that you guys got?

William J. Clough ***CUI Global, Inc. - CEO***
Yes, I think we've talked about this. We got the mechanicals from the French and they were absolutely inadequate. We ended up putting our electronics in and we were able to make it work, but we -- it still is not productized. So what we said is -- and the proposal was always that the French will build the mechanical portion of it, we would provide the electronics and then productize it and take it to market. We had to send it back to them and tell them, "Look, you're going to have to do a number of different things to make this mechanical work the way it needs to work." And they are now deciding whether they are going to pay us to do that or whether they are going to do that themselves. And frankly they just haven't made a decision yet. But we still have confidence that it can be done. We still have confidence

that it will work. We still have Snam Rete looking to deploy 1,300 units if we can get it. But it's going to be up to the French as to whether they're going to try and do the mechanicals or they're going to pay us to do it. And they just haven't made that decision.

Jeff Bernstein -
And any update on ENGIE and any kind of China plans?

William J. Clough *CUI Global, Inc. - CEO*
Yes, we are -- actually we are -- it's my understand that our sales guys are going to be meeting with ENGIE and PetroChina before the end of the year. I don't know -- I don't have an exact date yet but it's definitely going to be before the end of the year.

Jeff Bernstein -
And then lastly, this crazy new Italian incentive for burning waste, what's the fallout of that or is it too early to tell?

William J. Clough *CUI Global, Inc. - CEO*
Yes, that's exactly what I was talking about this morning with this Chairman who is doing the opening key address at the Shippers' Day today. He talked extensively about that. They are really going to start underwriting, much like the U.K. has biomethane fuel. They want to go heavily into biomethane fuel. Apparently, according to him, they are the third largest producer of biomethane fuel in the world, second in Europe, and they have about 8 billion cubic meters a year that they're losing right now. They have one very large plant that they have developed that have started processing fuel in June. They're very happy with that. But they know it's too big to deploy across the nation. So they are looking for a plan very similar to the U.K.'s where they would deploy these skids. And we have made a proposal to their technical team regarding our ability to put together the components that would have these skids workable. And I think it's going to be a big opportunity for us. I don't have a timing on it yet or anything there yet. But I do know that they're quite anxious to do it. They are very much looking at a plan like the French rolling out 1,000 or more biomethane to-grid skids, which would allow them to capture most, if not all of that 8 billion cubic meters a year.

Operator
And that concludes today's question-and-answer session. I'd like to turn the call back to Mr. Clough for any closing remarks.

William J. Clough *CUI Global, Inc. - CEO*
Just in closing, I would thank all of you for your patience and your support of the company. I can tell you that the management is very excited about the opportunities ahead of us. We're confident that we are going to move diligently forward to capture those and create the benefits that will increase the value to shareholders. And I just thank you for your continued support and reemphasize that if you have questions or we can supply information, Dan and I will always make ourselves available to you as long as you give us enough notice. So again, thank you again and that's the end of the call, operator.

Operator
Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program and you may now disconnect. Everyone have a great day.