CUI Global, Inc. Q4 2017 Earnings Conference Call

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Corporate Participants

C: William J. Clough – Chairman, CEO, and President, CUI Global, Inc.

C: Daniel N. Ford –CFO CUI Global, Inc. and COO, Energy Division

C: Sanjay Hurry – LHA Investor Relations (external Investor Relations)

Conference Call Participants

C: Eric A. Stine – Craig-Hallum Capital Group, Research Division - Senior Research Analyst

C: Jeffrey M.K. Bernstein – Samjo Capital, Analyst

C: Jon M. Fisher – Dougherty & Company, Research Division - Senior Research Analyst of Industrials

C: Orin Hirschman – AIGH Investment Partners, Portfolio Manager

C: Robert D. Brown – Lake Street Capital Markets, Research Division - Senior Research Analyst

C: Mike Wallace – White Pine Capital – Portfolio Manager

+++ Presentation

Operator –

Good day, ladies and gentlemen, and welcome to the CUI Global Fourth Quarter and Year-End 2017 Earnings Conference Call. (Operator Instructions) And I would now like to introduce your host for today's conference call Mr. Sanjay Hurry, you may begin.

Sanjay Hurry – LHA Investor Relations

Thank you, Kevin. Good morning, and welcome to CUI Global's fourth quarter and full year 2017 results conference call. A copy of the company's earnings press release in accompanying PowerPoint presentation to this call are available for download on the Events & Presentations' page of 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 fourth quarter and full year and to provide you with management's perspective on fiscal 2018. Following management's remarks, the call will be opened to question and answers. A telephonic replay of this call will be made available until March 29. 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, company's 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 its 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.

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

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Thank you, Sanjay. Good morning, everyone, and thank you for joining on our fiscal fourth quarter and full year 2017 results conference call. To begin, we are pleased to report consolidated revenue above street consensus estimates for the year that reflects strong year-over-year growth in our Power & Electromechanical segment. As I will discuss shortly, several factors brought the Energy segment revenue below fiscal 2016. Let me first start with our Power business.

Our Power business turned in an outstanding performance in fiscal 2017. Steps taken during the industry downturn years to broaden our distribution base and grow our direct sales paid off as the industry entered an upcycle. Power & Electromechanical revenues were up over 10% year-over-year or about 2.5 times the global industry average for the electronics industry. As strengthening industry fundamentals drove demand for our products. We attribute this faster than industry performance to double-digit growth across almost all of our product lines. This was due to several factors. First and foremost, a strong commitment to building and maintaining inventory levels by all of our channel partners. Second, increasing point-of-sale activity through those distribution partners, which along with strong inventory builds, provided us a stable flow of customers and design wins. Point-of-sale activity in our channel was the highest since 2014 with no cannibalism from adding new partners. In particular, our new relationship with Arrow Electronics one of the world's largest electronic distribution companies has continued to grow at an accelerated pace with considerable acceptance of our product lines by Arrow's large customer base. And third, we won several high production accounts marketed and designed-in during 2015 and 2016 that drove an increase in our direct business on top of which design activity was higher in 2017 than in 2016. This, in turn, has increased our visibility in the marketplace and generated additional customers.

Growth through innovation is also a core tenant of our Power & Electromechanical segment, and to that end, we are quite pleased by the progress of our ICE technology products in setting a new standard for power infrastructure utilization in the Data Center market. With the need to support explosive growth in IoT and mobile infrastructure, Data Center power has become a key priority for the industry. In late 2016, we placed 8 data ICE Power solutions with select channel partners and have since received excellent feedback. In 2017, we saw the marketplace's strong interest in the capabilities of the ICE platform convert into initial orders. Last October, we received an ICE switch order for almost 1,000 units shortly after securing safety certifications, which we have fulfilled in the current quarter. Just last month, we received our first order for ICE Block valued at $2.9 million, before securing UL certification. On Monday, we received and announced, receipt of full UL certification for our ICE Block, which now enables us to go to market with the entire ICE package, both Switch and Block, fully certified. The orders we have received to date are reflective of the strong reception the platform is commanding from a Data Center market, focused on finding ways to capture underutilized power capacity without compromising system availability or reliability. We are seeing continued strong interest in the ICE platform from prospective customers as well as from industry participants who want to private label our solutions. We remained convinced that our ICE platform will generate substantial growth for this business segment for a long time. At the year-end, Power & Electromechanical segment unaudited backlog stood at $20.2 million.

Now let's discuss the energy division. In our Energy segment, revenue and gross margins declined year-over-year due to the delay in our Italian project, fallout from Brexit and the recently concluded RIIO initiative in U.K., the effects of Hurricane Harvey in Houston, and a general malaise in the energy market. We continue to execute on business development activities over the course of fiscal 2017 laying the groundwork for greater adoption of our gas technology products across all of our key geographies. Let's first address the status of our Italian project.

Last fall, the Italian Regulatory Authority and the national gas transmission company in Italy resolved a year-long tariff issue that had halted a re-metering project to upgrade the 3,300 largest offtakes on the gas company's network. The resolution put in place a flat tariff to ensure compliance to the mandate. The resolution went one step further and included a proviso to ensure the future upgrades to Italy's critical gas infrastructure will proceed unimpeded.

The proviso called for the consolidation of ownership/management of all offtakes on the network, that's approximately 7,000 offtakes in total, under the gas transmission company as a matter of law. With the tariff issue resolved, our local distributor anticipated delivery and installation of inventory units to occur late last year. That has not happened yet due to - according to our in country partners - the regulatory authority opting not to issue its final ruling on the ownership management issue ahead of the national elections, which took place on March 4. While we are frustrated by the slow rollout of our GasPT contract, deployment of our GasPT order remains a matter of when and not if. An equally frustrating consequent of the slow rollout is that we have to take an impairment charge against our Orbital U.K. assets. Dan will address this charge in his remarks.

As a reminder, the Italian re-metering project is fully funded. Further, you will recall that the GasPT allows the transmission company to recapture up to 15% of revenue currently lost due to the inaccurate billing. In effect the transmission company is losing money every day it doesn't have GasPTs deployed. So while our visibility into the timing of future GasPT orders from Italy is limited, our device remains integral to the transmission company's infrastructure plans, both from an ROI and a technology standpoint. And now, we see a path to substantial expansion of our opportunity. Once the gas company takes over management of all 7,000 offtakes, we're perfectly positioned to grab orders to supply an incremental 3,700 GasPT devices.

Now let's discuss our other energy products. Our pipeline of potential energy product sales today comprises a larger number of major energy producers than at this time last year. In North America, in conjunction with our long-standing distributor Benchmark, we are spearheading efforts to position GasPT as a fiscal monitoring solution to supplement GasPT for process control applications. Measurement Canada has generally accepted all of the testing and certification for fiscal monitoring we accomplished in Europe, and our next step is to secure an in-field sponsor of field trials, a step-in process as we speak.

Staying with fiscal monitoring and turning to Europe, we are awaiting ENGIE's response for our bid to utilize GasPT as analyzer to their biomethane-to-grid build-out. We also begin to explore Italy's biomethane-to-grid needs, where the Italian government is already putting euros behind greater adoption of biomethane to meet EU requirements to generate 35% of their energy needs from renewable sources by 2022. The gas industry believes that biomethane is likely the biggest beneficiary of this mandate given that it will use the current gas infrastructure, the same pipelines and same delivery system, to achieve this goal. We also continued to progress of one of our largest opportunities for the GasPT solution, the Future of Billing Methodology or FBM, project in the U.K. Ofgem's approval last fall of the Stage Gate Report for FBM moved the project ahead the Phase II. Given the size of the opportunity in U.K. alone, we have opted to move forward on our own, designing the solution and proceeding with its development to Phase III. Concurrently we are evaluating partner candidates who can help us take the FBM solution to the market. We have held initial meetings with energy providers in Canada, Asia and Western Europe to replicate FBM in those geographies and to date the receptivity has been very encouraging. Formal trials for the new solution are scheduled to begin before year-end with a 'go live' in 2019 or early 2020.

To further expand our footprint in Europe, we are establishing a distributorship with Samson AG, a German supplier of components for the utility industry. Samson compliments our direct salesforce's efforts to the national or otherwise a large energy producers, with a focus on a very broad array of low-volume opportunities that are large users of natural gas such as glass, ceramic and steel manufacturers, along with certain large food producers. As a process control application, GasPT offers us a greenfield opportunity in North America. We recently announced our latest repeat order for a GasPT device from a leading U.S.-based power and energy transporter who is using it to optimize the efficiency and minimize maintenance on certain of its gas-fired compressor turbines in the Northeastern United States. As encouraged as we are about this incremental order, our most advanced process control opportunity is at a standstill as we await our partner completing its certification trials on our GasPT for use as an OEM part or a retrofit in the gas turbines worldwide. Our VE technology saw a significant uptick in interest following last summer's demonstration at Southwest Research Institute. We are seeing demand build for our sampling probes and systems across a broad array of applications from thermowells to trace element detection. We are moving forward with orders with every major energy producer and the tenants at the Southwest demonstration. We have made significant inroads raising this technology's visibility to other major market participants and are in more, large dollar value bids today. Late last year, we announced a second order for our sampling system for a second ethylene plant, which we have fulfilled in the quarter.

In our integration business, late last year, we opened a new and much larger facility with a higher capacity in Houston. In our prior smaller facility, we were growth constrained in a number and scope of work we could bid on. This new facility removes of our biggest barrier to larger contracts from energy operators in this region. With crane access throughout our new facility and ability to manage bigger projects, we are already being evaluated for inclusion on the corporate approval list for a large petrochemical company. So, while we saw a downturn in business last quarter due to the end the impact of hurricane Harvey, the upturn we are seeing based on repair and other work created by the hurricane will make the disaster a net positive for Orbital. We are winning competitive bids based on our project excellence, reliable performance and quality engineering and once we are in one project, we have a leg up on additional projects. We are winning in part because internal integration teams don't have the talent to provide complex integration, but, we do, and our capabilities have been noticed. To quote one recent customer, "If you want a solution talk to Orbital".

We also offered turnkey solutions that marry our engineering services to our energy products. Our ability to leverage integration sales to drive for greater adoption of our gas technology products and vice versa became evident in 2017. We recently announced a $2.1 million integration project that was our third from the same customer and the first out of our new Houston facility. This integration award also included a sale of VE sampling system probes. Just yesterday, we announced the $4.58 million Orbital U.K. integration order that was a first for us in that it was our first non-biomethane project with GasPT and VE technology spec'd into the project. Our VE technology, in particular, is proving instrumental in establishing Orbital on approved vendors list. This product has opened doors for presenting our integration capabilities to companies where we have little or no traction. By allowing faster cleaner samples of the gas to be provided to any number of analytical devices, with no complex expensive calculations that are required for standard non-VE probes, our VE technology is a leader in replacing both standard thermowells and sampling probes throughout the natural gas infrastructure.

While we saw stronger business trends from our Houston facility, our Orbital U.K. facility saw the postponement of bigger integration project in Western Europe due to post-Brexit-business uncertainty. In addition, in the U.K, National Grid, which has historically been a large integration customer, put all infrastructure CapEx plans on hold as it divested itself of its distribution business. We've engage the spinoff and have recertified ourselves with them and are now waiting for them to develop their capital investment program as a stand-alone company. At year-end, Energy segment unaudited backlogs stood at $12.6 million.

In summary, new technologies, even technology that's as disruptive as ours, rarely have a linear adoption rate. We deal with government and quasi-government entities and delays invariably occur. It is therefore fortunate that we took a preemptive step in raising capital last fall, ensuring we have the financial resources and flexibilities to drive adoption of our energy products.

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. Starting with our consolidated results for the fourth quarter, total revenue was $21.1 million, an increase of 9% from $19.4 million for the fourth quarter of 2016, reflecting a $2.1 million increase in revenues from the Power & Electromechanical segment, offset by $400,000 lower revenue on our Energy segment. Largely as a result of lower contribution from our Energy segment, consolidated gross profit margin was 250 basis points below last year at 30.9%, although consolidated gross profit was flat at $6.5 million.

Consolidated selling, general and administrative expenses for the fourth quarter were $8.4 million, an increase of $0.5 million or 7% compared to the prior year fourth quarter, reflecting increased activities in support of the increased revenues and marketing efforts during Q4 2017. During 2017 the company began implementing various cost-saving measures which resulted in a slight decrease in total cost during 2017, and are expected to provide further improvements in 2018. While SG&A expense increased in absolute dollar terms as a percentage of revenue, SG&A was lower at 40% revenue for the quarter. Adjusted EBITDA loss for the quarter was $2.3 million unchanged from last year.

For the fourth quarter, we recorded a $3.2 million goodwill impairment charge associated with our Orbital U.K. subsidiary to reflect the longer than expected temporary halt in shipping of our GasPT devices under our contract with the national gas transmission company in Italy, as Bill discussed, and the overall market in the U.K. following Brexit, including a slow biogas industry during 2017. The remaining goodwill related to the Orbital U.K. entity amounts of $4.5 million. As a result of this impairment charge, net loss for the quarter was $5.3 million or $0.20 per share compared to a net loss of $2.6 million or $0.12 per share for the same period last year. Turning to our segment revenue and gross margin, I'll start with our Power & Electromechanical segment. Revenues for the quarter were $15.9 million compared to $13.8 million last year, an increase of 15%. On a sequential basis, Power & Electromechanical segment revenues decreased 5%, reflecting normal seasonality in the industry. As has been the case for each quarter, this fiscal year, we're benefiting from the electronics market upcycle, the broader base of business we established over the past several years with new distribution partners, new design wins and new product introductions. We are pleased that this trend has continued into Q1 2018 as well.

Gross profit for the fourth quarter was $5.3 million or 33.3%, a 120 basis points improvement over last year's 32.1%, reflecting an improved product mix and a continuing focus on improving margins within our power segment through increasing efficiencies and controlling variable costs at our Canadian manufacturing facility, along with continuing new product introductions to the Power & Electromechanical marketplace. During 2017, CUI introduced more than 1,100 new products in this segment. Our Energy segment produced revenues of $5.2 million, slightly above the third quarter and slightly below last year when we reported revenue of $5.6 million. The year-over-year variance reflects the timing of customer project schedules and generally the slower U.K.

market during 2017. Revenues for the quarter were more heavily weighted toward lower margin integration projects. As a result, gross margin for the quarter fell to 23.3% from 36.4% last year. As a reminder, 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.

Consolidated backlog was $32.8 million at quarter end compared to $30.2 million at December 31, 2016. Backlog for the Power & Electromechanical segment was $20.2 million an increase of $2.1 million compared to $18.1 million at December 31, 2016. This reflects the inclusion of the ICE Switch order received during Q4 2017, as well as the continued uptick in the power market. The Energy segment backlog at quarter end was $12.6 million compared to $12.1 million at December 31, 2016. For the year, we generated consolidated revenue of $83.3 million compared to $86.5 million for 2016. With increased Power & Electromechanical segment revenue offset by lower Energy segment revenue, Power & Electromechanical revenue grew 10% to $64.4 million from $58.4 million for 2016, while Energy segment revenue was $18.8 million compared to $28.1 million last year, a 33% decline.

Consolidated gross profit decreased 14% to $27.9 million from $32.3 million for 2016, reflecting unfavorable segment mix associated with lower sales of high margin product in our Energy segment. Likewise, consolidated gross margin fell from 37.3% to 33.5%. On a segmented basis, Power & Electromechanical delivered a gross margin of 34%, slightly lower than last year 34.8%. And energy reported across margin of 31.5% compared to 42.5% for 2016, which benefited from significant GasPT deliveries. SG&A was $33.9 million compared to $34.2 million for 2016, reflecting primarily lower overall severance costs and various cost-saving measures begun in 2017. We expect SG&A expenses will improve as a percentage of sales in 2018 due to the implementation of these cost-saving measures and forecasted revenue growth. Research and development increased 25% to $2.5 million compared to $2 million for 2016, due to higher expenditures on advanced power technologies, including ICE as well as on GasPT and VE technologies. We expect research and development will be flat with 2017 as we continue to pursue new technology-based product introduction.

As a result of a decrease in consolidated gross profit, an increase in research and development expenses, adjusted EBITDA loss widened to $7.4 million compared to $3.2 million for 2016. Net loss for the year was $12.6 million or $0.56 per share compared to a net loss of $7.3 million or $0.35 per share for 2016. As a reminder, net loss for the year included a goodwill impairment charge of $3.2 million. In terms of our balance sheet, we ended the quarter with cash and cash equivalents of $12.6 million, up from $4.6 million as of December 31, 2016, reflecting the net proceeds of $18.9 million from the equity raise we closed in October 2017, a portion of which was used during the fourth quarter to repay a line of credit and overdraft facility balances, and to support ongoing business activities. That concludes my prepared remarks. I will now turn the call back to Bill.

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Thank you, Dan. For my earlier remarks, I hope you have conveyed that our strategy to drive demand for our solutions across both of our business segments in fiscal 2017 is yielding multiple paths for faster growth in fiscal 2018. We expect continued strong performance in our power business with the introduction of the new ICE solution serving as a key driver of growth in our Power & Electromechanical segment. In our Energy segment, we are seeing forward movement in integration projects previously suspended in Western Europe that, together with potentially larger dollar value opportunities out of our new Houston facility, and the steps we've taken to seed the market for additional energy product sales across multiple geographies, put us on a growth path in our Energy segment. Further, we are realizing synergies between our integration and products businesses that should serve as an additional catalyst for energy revenues. These efforts are already yielding positive returns. We are seeing stronger business activity as prospective consumers respond favorably to the value proposition of our energy products and we have generated almost $7 million in new energy products year-to-date. Finally, our capital raise enables us to replenish the balance sheet without losing a step in executing on our growth strategy. This concludes my prepared remarks. Operator, please open the call to questions.

Questions and Answers

Operator

(Operator Instructions) Our first question comes from the Eric Stine with Craig-Hallum.

Eric A. Stine – Craig-Hallum Capital Group, Research Division - Senior Research Analyst

I just want to make sure I understand, what's going on Snam Rete, and I understand that timing is very difficult to call here. But -- so now that the election is done, you believe that they will -- or put in place the process or start the process of taking ownership of the of offtakes and then -- that opens the door for the installations to start, is that the way to think about it?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Yes, actually though it's not them making the decision. They are ready to move at a moment's notice, they've already told us to be on, to be prepared to move quickly, but it's a regulator. The regulatory authority we believe is waiting for a government to be in place -- actually we don't believe it, they believe it, is waiting for a government to be in place. And again, the timing is difficult because of the way the government is structured over there as you may know there was an election on March 4. You've read anything about that election, you had 3 parties running, no party received a significant majority. So now 2 of the 3 have to make a coordinated effort to put together a, in essence, a consolidated Government. If they do that, which they are attempting to do then they will have a Government. If they don't, and I believe it's about 3 months that they have to do that, then they have another General Election. So it's a -- it's a matter of really waiting for their political situation to straighten out. But yes, once it happens, they will have control -- management control of all 7,000 offtakes, which is the good news. And further, the good news is, there are quite eager to get this going. They know that they're losing money every day by not having it going. So again it's -- but it's a difficult timing issue.

Eric A. Stine – Craig-Hallum Capital Group, Research Division - Senior Research Analyst

Right, no, I get that. And then -- but that is something once the go-ahead is given then what is it an additional 350 (GasPTs) that Socrate would have in inventory that they would have to get through before then you would look for a follow-on? I mean that has to be pretty quickly.

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Yes, they -- not only would it be quickly, I think they would start -- I already told them we need time to ramp up all and that ramp up is going to take a period of time. So I'm pushing them very hard that the moment they have the ability to move forward, they need to start talking about scheduling and how they're going to do that and when they're going to need units. And they're very eager to do it. They're quite enthusiastic, they still have the same team in place. The project manager has not been reassigned, she is in charge of just that project. So again, I think they'll move forward quite quickly once they get this final hurdle taken.

Eric A. Stine – Craig-Hallum Capital Group, Research Division - Senior Research Analyst

Got it. Okay. And then maybe just turning to GE. I mean just, I know that, that still you're waiting there as well. Just to confirm, I mean, the testing -- is the testing been completed that they needed to see? And then I think then it was just a matter of trying to work towards an initial order and I think you've talked about potentially in the 20 to 30-unit range.

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Yes, I think that's all true. And we're obviously not identifying GE by name, but yes, I mean, obviously we are awaiting their response. Again, it's not something that they -- again, if you look at the press surrounding what's going on with their power and water division, which is where we are, they've got some things happening there that they have to get through.

Eric A. Stine – Craig-Hallum Capital Group, Research Division - Senior Research Analyst

Yes. All right, I guess, last one for me just on the ICE Block and the ICE Switch. Now you've got certification. In the past you'd talked about certification and a few other hurdles before you go to market. But I mean you're commentary today and in the release earlier this week would indicate that you're ready to go to market now. So I mean, is it kind of all systems go? Or are there a few additional steps before you really start to hit the market?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

We're in market. There's no additional steps. We are moving forward in market. We're in market with our partners, both VPS and our channel partners, and we're quite excited about moving forward. But it's full speed ahead for us on that.

Daniel N. Ford – CUI Global, Inc. – CFO

The technology is actually being demonstrated at Data Center World this week, so it is live and out there to the market.

Operator

Our next question comes from Rob Brown with Lake Street Capital.

Robert D. Brown – Lake Street Capital Markets, Research Division - Senior Research Analyst

I just wanted to look back at Italy, just want to clarify, how many units are in inventory waiting to be installed? And I guess, I'd like to get your thoughts on once things start to move forward, when you can get orders. Is this something you could conceivably get in '18 or is this really now pushed out to '19?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

No, I think once -- first of all, about 350 units are in inventory. But no, I think, once they start moving, it'll move quite quickly. And I'm -- again, I don't want to predict, it will move quickly once they start, I can't imagine it's not going to occur this year. And frankly, we're hoping that it occurs either late this quarter or into second quarter. I know that they are quite eager to get things going. I know that they're quite enthusiastic about it. That money is burning a hole in their pocket in the sense that it's already -- it's sitting there committed to this project. So again, it's dependent, obviously, on them getting a government together but once that happens I think it'll -- we'll move quite quickly and we expect it to be this year.

Daniel N. Ford – CUI Global, Inc. – CFO

We also are still under the understanding from them that their goal is to be doing 100 a month so that should burn through the existing inventory fairly quickly and allow for a build schedule to ramp up quick as well.

Robert D. Brown – Lake Street Capital Markets, Research Division - Senior Research Analyst

Okay. And as far -- on the U.K. feature billing phase 3, could you clarify did you accelerate something in that project? Or is that -- is the timing change there?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

No, the timing is still the same. We're going to do a deployment, in fact I believe, it will start sometime in the next few months, that will in essence, be what amounts to a field trial. That field trial will take place through the end of this year probably into 2019. And then assuming that everything works the way it has to date, they want to see deployment in 2019 or early 2020. So no, there's been no real acceleration. What we have done though, is while we're still discussing partnerships with Italy and with Ofgem and with DNV GL, we're starting to move forward on the solution front, the R&D front ourselves, actually putting together the final solution, which will include both the analytics and power.

Robert D. Brown – Lake Street Capital Markets, Research Division - Senior Research Analyst

Okay, good. And then one more question on ICE Block, what sort of the sales cycle there? How quickly now that you’re in-market do you sort of expect orders? And can you remind us again sort of the revenue rate per data center?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Dan, you want to go through that?

Daniel N. Ford – CUI Global, Inc. – CFO

Yes, I'll take that. So the sales cycle, it's a new technology. So we know that, that's difficult to predict. But these are going to be part of generally large capital programs, where there either building a new facility or revamping power and hardware in their facility. So it's going to be a longer sales cycle. We expect to do somewhere around $3 million to a $5 million of revenue this year is our goal, we -- but really the goal for a 2018 is to get sales orders in place for build schedules for 2019 deliveries. So that's what we're looking to and we're working through a number of sales channels with VPS and our partners in this space and presenting at key conferences like Data Center World this week to get off there. We -- just like with the ICE Switch order last fall, the ICE Block order that has come through this year, in fact before we had certification, it's earlier than we had expected when -- if we were talking a year ago, so that's a good indication of possibly the speed of adoption that could take place. But revenues this year are going to be somewhat limited due to availability of key components, particularly batteries in the marketplace this year. We do have an allocation that supports beyond our target goal for the year. But batteries are a constraint for 2018. And we have that resolved for what we believe is of our volume necessary this year and then into 2019, we don't see that as an issue either.

Operator –

The next question come from Jon Fisher with Dougherty & Company.

Jon M. Fisher – Dougherty & Company, Research Division - Senior Research Analyst of Industrials

So just kind of staying with the revenue topic here. On power and electro, given the strong year that you had this year, the Arrow relationship, building out distribution and in growing that, can you grow that business double digits in 2018 versus 2017, if you exclude kind of the $3 million to $5 million ICE Block revenues that you're targeting this year?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

I think that business can grow. Frankly we've seen a significant upturn both in the electronics industry and particularly in our customer base. So I think yes, it seems to be growing at a double-digit rate during the first quarter, which is historically actually a lower quarter for us after Christmas sales and whatnot. So again, I think, it's something that can continue. We again normally expect somewhere between 4% and 6% but it could certainly continue this year in to double digits. We see some real strength in the electronics market worldwide right now.

Jon M. Fisher – Dougherty & Company, Research Division - Senior Research Analyst of Industrials

Okay. And so than the $3 million to $5 million, I mean the ICE Block momentum, and the UL certification all of that momentum would be incremental to what we could call kind of core organic growth for that segment then right?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

That's correct.

Jon M. Fisher – Dougherty & Company, Research Division - Senior Research Analyst of Industrials

Okay. Okay. Moving onto the expense side of things. When you look at SG&A spend, kind of fluctuated around $8.5 million a quarter, excluding Q3 for most of 2017, is that the right way to think about SG&A spend for 2018? Or with some of the cost cutting that you did, could SG&A be running from a spend standpoint at a rate slightly below the kind of that $8.5 million rough bogey?

Daniel N. Ford – CUI Global, Inc. – CFO

Sure I believe $8.25 million to $8.5 million is a safe place to build a model based on -- we do see SG&A improving as a percentage of revenues, i.e. we don't expect that to increase nearly with the rate of revenues. But I think if you're in that range you're in a good target place.

Jon M. Fisher – Dougherty & Company, Research Division - Senior Research Analyst of Industrials

Okay. And then on gross margins, given kind of some of the delays that are continuing to go on the energy side and a strong growth that you are seeing in power, not sure kind of what the margin contribution benefit or dilution is from the ICE Block momentum. But should we expect in gross margins that kind of run closer to the low 30s given the revenue mix is likely to play out here in 2018? Or what is the possibility of running closer to mid-30s types of gross margins this year?

Daniel N. Ford – CUI Global, Inc. – CFO

Until we have a higher value product sales starting to kick through, meaning higher volumes on ICE, but most importantly higher volumes on GasPT sales, that's when we'll see that margins start to uptick more and more. Our goal would be to get to the mid-30s this year or higher with higher volume GasPT sales, but mid-30s would be our goal for the year.

Operator –

Our next question comes from Jeff Bernstein with Cowen.

Jeffrey M.K. Bernstein – Samjo Capital, Analyst

Just a couple of follow-up questions. Can you just talk a little bit more about the North American energy company order for compression-related system, is that for infield compression, is that for a fractionation plants? Or what is that for exactly?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Yes, the infield pipeline compression, it's a large Northeastern compressor group that is a large transporter of a natural gas in Northeast. They're going to roll the technology out across their entire fleet, which is around a 400 compressors as I understand it, and they've continue to doing that on a project by project basis. And this, I think it's the fourth order that we've taken from them over consecutive months, is just an illustration of that. We think if we can make that kind of impression on other compressor and compressor users, there's a very healthy market in the U.S. for that.

Jeffrey M.K. Bernstein – Samjo Capital, Analyst

Yes, it's a big market. Okay. And then on last page here of your presentation, you give some TAM analysis on ICE technology. The large Data Center number, obviously, big number $30 million, is that to you or to you and your partner for a single large Data Center?

Daniel N. Ford – CUI Global, Inc. – CFO

That's just the hardware for that side of the Data Center and that's a tremendous size Data Center being put together.

Jeffrey M.K. Bernstein – Samjo Capital, Analyst

Got it. And I know there's been some press about the product and virtual power and some of the people you guys are talking to et cetera and some commentary that the big Data Center builds are going to be in China. And they're very interested in power saving technologies, whatever. How do you sort of navigate the China market?

Daniel N. Ford – CUI Global, Inc. – CFO

Well, we're partnering with some companies with -- to do direct installations around the globe that have the capabilities of protecting that hardware and it's a key technology, it's also protected by the software component that goes with it. So without the software relationship and the componentry within our devices, which is quite unique and ornate, I would say, it'd be difficult to replicate, if not impossible for a very long time. So I think we're very well protected from a hardware standpoint as well as the software. We're also going like I said, with large partners into those places that have been mentioned in press releases. So we're pretty well backed up in going into markets around the globe.

Jeffrey M.K. Bernstein – Samjo Capital, Analyst

Got you. So no issue with getting distribution into that -- into the Chinese market?

Daniel N. Ford – CUI Global, Inc. – CFO

We see no issues with that.

Jeffrey M.K. Bernstein – Samjo Capital, Analyst

Got you. And then lastly, Bill, could you just walk through a little bit FBM and it sounds like you're proposing something similar in other countries. Could you just flush that out a little bit more?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Sure. We've taken the concept now to Canada and most particularly into Japan with Osaka Gas and Tokyo Gas. And in fact in 2019, Japan is broadening quite significantly their CV range. They have been a very narrow range country up until now just recently, but they're going to broaden that range quite significantly because they think they have an opportunity to actually become a domestic producer of biomethane gas, which of course would be great for them because they have no domestic energy production to speak of.

So because of that they're quite interested in the Future Billing Methodology because of that's the way they could deliver that biomethane gas to the end user. We have had good kind of response from couple of contacts up in Canada as well and so we've presented and we're making the presentation, obviously, across Western Europe to our partners in Italy, to the French and others. So we just think that this is as alternative energy becomes a big issue, primarily now in Europe but it's going to be across the world, we think, that biomethane gas is going to be the response. And the need for Future Billing Methodology becomes that much more significant, and I think we're at the leading edge of that. So that's the deal as we're presenting it in every way where we can present it, and we're seeing some great interest both in Canada in North America and in Japan and Asia.

Jeffrey M.K. Bernstein – Samjo Capital, Analyst

So this would be sort of the Phase 3 integrated skid with all the equipment and analytics et cetera, that you're composing that this is how other guys should do it?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Yes it's not even a skid, it's actually the downstream billing, the fiscal monitoring. It's a solution that we're providing an analytic, a flow meter and a power device that would allow the billing to be done much closer to the customer. So, in the case of the U.K, it would be in essence within almost a mile of the customer so you'd have about one of our devices for every 500 customers. That's how you get the [roll] idea of 23 million customers about 45,000 units. But because you're so close to the customer, you can put almost anything you want upstream because the customer is being billed accurately downstream. And that's the key that would work the same in Japan, it would work the same in North America and Canada, it would work the same in Italy and in France. So that's the deal, it's not really -- it's not preparing the gas like a biomethane skid for delivery, it's actually billing the customer in an accurate basis for what they're getting.

Daniel N. Ford – CUI Global, Inc. – CFO

The key for doing that, Jeff, just to be clear, it allows the producer to not have to inject dirty gas or propane to enrich that gas coming from the biomethane facility. So it allows the true naturally occurring biogas to enter the grid without being enriched and essentially made into a complex carbon, thereby getting the full environmental benefit of it.

Jeffrey M.K. Bernstein – Samjo Capital, Analyst

Got you. And then just lastly, in terms of the U.S. I know Florida now has got I think some feed-in tariffs for biogas going. Things are moving there. What's happening in other states in the U.S?

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Actually the biggest opportunities we see right now in California and Oregon. Those 2 states are quite aggressive moving forward as probably again, it's big press. They do not recognize the withdrawal from the Paris Accord, they're still going to move as if we are participant. And we actually have some pretty significant bids outstanding right now. And I think there may be some nice announcements over the next few weeks and months regarding biomethane to grid hookups that we're going to be doing in the U.S. But again, I think our target markets right now are predominantly California and Oregon. I think we also have a bid out or a couple of bids out in Canada. I think one in Toronto and one in some other province in Canada. But again, I think California and Oregon are both moving forward.

Operator –

(Operator Instructions) Our next question comes from Orin Hirschman with AIGH.

Orin Hirschman – AIGH Investment Partners, Portfolio Manager

Could you just recap again, there actually was revenue recognized this past quarter that you reported on the ICE shipments there, first ICE shipment?

Daniel N. Ford – CUI Global, Inc. – CFO

No, the first ICE shipment is delivering in Q1 of this year. We got our first order received in Q4 of '17 for delivering Q1 of '18.

Orin Hirschman – AIGH Investment Partners, Portfolio Manager

Okay. And that's then the one -- that one specific Data Center order that was described before?

Daniel N. Ford – CUI Global, Inc. – CFO

That’s the ICE Switch, it was 950 units. Press release I believe was in mid-October describing that one.

Orin Hirschman – AIGH Investment Partners, Portfolio Manager

Okay, okay. I guess my question is when does the next order flow? You had the next order in-hand yet?

Daniel N. Ford – CUI Global, Inc. – CFO

So we just got the order for the ICE Block and that's going to be delivering -- it's currently scheduled to delivering late 2018.

Orin Hirschman – AIGH Investment Partners, Portfolio Manager

That's the same customer though?

Daniel N. Ford – CUI Global, Inc. – CFO

It's a mix of customers. It's through the same channel though.

Orin Hirschman – AIGH Investment Partners, Portfolio Manager

Through the same channel, okay. I mean what do you think that really make the difference in terms of trying to get -- you mentioned there were lots of test sites. What's going on with some of those beta sites?

Daniel N. Ford – CUI Global, Inc. – CFO

Well, the key was to be able to go to market, we had to get the certifications from the safety agencies. So we have those in place now and we can go out, they can put them in a live test environment, not just in the lab environment or safety environment. So they can now test in a live server data facility. And they can decide how they want to run a CapEx program around that or a new development program around that. So how we go to market with that is, we're working with a number of partners to do that. Like I mentioned earlier, we're at Data Center World presenting to the largest Data Center companies with the technology. And it's going to be about getting in their capital -- CapEx programs and upgrades systems, and working with them on those programs. So, I mentioned earlier in the call, it's a longer sales cycle. It's not delivering power supplies for a product run this year. It's delivering actual hardware to operate the server facility. So we see 2018 being revenues around or slightly more than the volume of purchase orders we've received so far. And then -- but the key is getting orders and schedules for 2019.

Operator –

(Operator Instructions) Our next question comes from [Mike Wallace with White Pine Capital.]

Mike Wallace – White Pine Capital, Portfolio Manager

A couple of questions on EBITDA margins and maybe give us some thoughts on -- in both segments. As the ICE technology gets out in the market, what sort of impact that's going to have on the EBITDA margin in the Power & Mechanical segment?

Daniel N. Ford – CUI Global, Inc. – CFO

As the year progresses, it should have a strong benefit. This first run, I'm not expecting a significant contribution from an income standpoint. The further order, the second order that we got, I am expecting margins to be pretty good on that, probably low to mid-30s on that, so that should fall down to earnings later this year. And then our next order -- or all orders subsequent I would expect similar margins on that. So that's how we see that coming through the year and through the EBITDA and earnings lines.

Mike Wallace – White Pine Capital, Portfolio Manager

So a 30% on the gross line and what would be reasonable on the EBITDA line then? And how many (inaudible) uptick could we see as we go through the year?

Daniel N. Ford – CUI Global, Inc. – CFO

Yes, so the contribution from that is going to be pretty similar to the gross margin on ICE. Once -- there's not a lot of additional SG&A frankly beyond -- well, actually I don't expect any additional SG&A beyond what we already have in place right now to support those sales. So it should continue to flow through. And that's in large part because of the partnerships that we have in place for doing distribution installation of that, where we're not building out a team to go out and do installs, or go out globally and market on our own, we're teaming up with partners to do that.

Mike Wallace – White Pine Capital, Portfolio Manager

So would it be in the range of like 200 to 400 [basis] points this year, of improvement and the margin there?

Daniel N. Ford – CUI Global, Inc. – CFO

Yes, it very well could be. Yes.

Mike Wallace – White Pine Capital, Portfolio Manager

Okay. And then looking at the energy side, excluding any of the PT devices, what can we expect to see in terms of margins on that segment?

Daniel N. Ford – CUI Global, Inc. – CFO

So for the integration segment, we were looking to be in the 32% to 35% range on integration and continue to work to improve margins on that area. It is a highly competitive space. So some jobs we do hit mid-20s, but the goal is always to be in the 30s range, which is our target. And then with GasPT, that can obviously go up -- that can then bring the segment up dramatically as it did in 2016.

Mike Wallace – White Pine Capital, Portfolio Manager

But is that a gross margin number, Dan, or an EBITDA number?

Daniel N. Ford – CUI Global, Inc. – CFO

Sorry, those are gross margin numbers.

Mike Wallace – White Pine Capital, Portfolio Manager

And if you drop it down to an EBITDA, give the write-off at Orbital and some things, how should we think about that margin?

Daniel N. Ford – CUI Global, Inc. – CFO

Well, I think the way to think about that is the SG&A is not going to change a whole lot, is our current plan. We expect revenues to pick back up. So -- and margins to improve. So with those 2 things I think we're going to see an improvement in the bottom line. Obviously the goodwill is a one-time item, is our expectations on that, as we see a strengthening in the business right now and forecasting through the year. I don't want to give a -- and I'm not going to be able to give you a number or a forecast number for you right now. But I see it improving during the year with revenues being the primary driver for that.

Mike Wallace – White Pine Capital, Portfolio Manager

Will it be breakeven or profitable on an operating line, EBITDA line for 2018? Given all the [Gas]PT stuff.

Daniel N. Ford – CUI Global, Inc. – CFO

It has the -- not excluding the [Gas]PT stuff, I would not expect that this year.

Mike Wallace – White Pine Capital, Portfolio Manager

Okay, so we need the [Gas]PT to come in to get that margin.

Daniel N. Ford – CUI Global, Inc. – CFO

Yes.

Mike Wallace – White Pine Capital, Portfolio Manager
Okay. And -- well essentially Italy is going to have a government. So that's the turning point...

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Well Mike, we certainly hope so. Don't we? We certainly hope so.

Mike Wallace – White Pine Capital, Portfolio Manager

Okay, yes. I just want to make it clear that once the government has formed, Bill, that's the trigger point for the rest of it to go? (inaudible)

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

It might be even before that. The bottom line is the regulator has already closed everything to public comment. They've already got the regulation written. The whole thing is in place. It's just their -- I think and to some extent Snam is in the same position we are. They are trying to predict something and they really don't have the insight to be able to say. So it could happen even without, or absent this government being resolved. But I think it's more likely once the resolution occurs, than not. But again, I know that they want to move this forward and it's strictly ‘follow the money’. I mean they can make more money with this and that's what they want to do.

Operator

Well, ladies and gentleman, that's going to conclude the Q&A portion of today's conference. I'd like to turn the call back over to our host.

William J. Clough – CUI Global, Inc. – Chairman, CEO, President

Just in conclusion, I want to thank everybody for their time and attendance. Again, we're moving forward on all fronts and we'll look forward to talking to you in the next couple of months with our first quarter results. Thank you, and thanks to everybody.

Operator –

Ladies and gentlemen, that concludes today's presentation. You may now disconnect and have a wonderful day.