CUI Global Inc. Q4 2018 Earnings Conference Call - Transcript

18 March 2019

CORPORATE PARTICIPANTS

- **Sanjay M. Hurry** –Investor Relations Counsel
- **William J. Clough** - CUI Global, Inc. - Chairman, CEO, President & General Counsel
- **Daniel N. Ford** - CUI Global, Inc. – Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

- **Eric Andrew - Stine** Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst
- **Robert Duncan Brown -** Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst

PRESENTATION

- **Operator**

  Good day, ladies and gentlemen, and welcome to the CUI Global 2018 Fourth Quarter and Full Year Results Conference Call.

  (Operator Instructions)As a reminder, today's conference will be recorded for replay purposes.

  It is now my pleasure to turn the conference over to your host, Sanjay Hurry, Investor Relations. Please go ahead.

- **Sanjay M. Hurry – Investor Relations Counsel**

  Thank you, Haley. Good afternoon, everyone and welcome to CUI Global's Fourth Quarter and full-year 2018 results conference call. A copy of the company's earnings press release and accompanying PowerPoint presentation to this call are available for download on the events and 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 quarter and for the full year and to provide you with management's perspective on fiscal 2019. Following management's remarks, the call will be open to question and answers.

  A telephonic replay of this call will be available until April 3. You may also access the archived website and accompanying PowerPoint at any time on the Investor Relations page.

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, 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 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 said, I'd like to hand the call over to William Clough, Chief Executive Officer. Good afternoon, Bill.

- **William J. Clough - CUI Global, Inc. - Chairman, CEO, President & General Counsel**

Thank you, Sanjay. And thank you everyone for joining us on our call this afternoon. As you've seen from our earnings press release, there's a lot of accounting noise in our fourth quarter financial results. Dan will take you through review of our GAAP results, but I want to begin today by putting aside the noise to share with you what I see.

I see a company executing financially across each of its business segments. We turned in an outstanding performance in the fourth quarter. Revenues were up 28% year-over-year and beat consensus estimates. Our gross profit, excluding the noncash charges of flow-through cost of revenues, was up 45% with gross margin up 430 basis points. Adjusted EBITDA improved incrementally. Power and Electromechanical segment revenue was up 23% year-over-year or about 4-X the global industry average for the electronics industry. Energy segment revenues were up 42% year-over-year and up 44% sequentially, as backlog converted to revenue with customers delivery schedules timed to take advantage of the U.K.'s domestic renewable heat incentives or RHI for Biomethane project initiative that passed in late May.

Our ability to offer the unique GasPT technology and a turnkey solution that engineers our energy products into our integration solutions is substantial competitive advantage in the marketplace, and one that enables us to deliver significant value for the customer and the growing market for Biomethane.

I'm similarly pleased with our full year performance. Consolidated revenues were up 16%, and here too, we are above consensus estimates. Our year-over-year performance was led by our Power and Electromechanical segment. In our Power and Electromechanical segment, revenue increased 19% and was driven by introducing new products including ICE products and strong performance by our distribution partners. At year-end, Power and Electromechanical segment unaudited backlog stood at $21.8 million, an increase of 8% year-over-year. The segment was very profitable over and above the noncash charges that flow-through cost of revenues and the royalty we paid to VPS in this year.

Recall that under our prior agreements with VPS may incur royalty expenses on sales of our ICE products with royalty rate highest on the first $1.4 million of ICE product revenues.

In our Energy segment, it was a tale of 2 halves with revenues in the second half of the year up about 63% over the first half following the passage of the RHI. Such is the impact of the U.K.'s Biomethane infrastructure build out that our largest Biomethane customer has indicated to us that it is moving forward with additional projects, even without having first secured the RHI subsidy and their preferred vendor is Orbital-UK. At our new Orbital facility in Houston, it was a year of growth across the board in terms of revenue, backlog and pipeline of opportunities. At year-end, Energy segment unaudited backlog stood at $15.7 million, an increase of 25% year-over-year.

Now, let me touch on the noncash charges we took in the fourth quarter and the year. It won't surprise anyone to learn that these charges relate to the U.K. public utility sector, which has been slow to recover from the economic dislocation triggered by the U.K.'s decision to leave the EU, Brexit, as well as the delay in our Italian order. For its part, Brexit hasn't allowed U.K. operators to invest in their infrastructure as they normally would. However, our customers in Italy and U.K. tell us that they are all still onboard with our technology, still committed to our projects and still moving forward with us.

During 2018, we focused on broadening our opportunity set in our 2 business segments. In our Power and Electromechanical segment, we introduced almost 1,300 new products, including ICE Block and ICE Switch for which we received an initial order. Several of our innovative products and technologies have been awarded or shortlisted for some very prestigious industry awards. We are known for delivering next generation technologies and products. Because of the recently enacted tariffs on products imported from China, our costs have increased and we have raised prices. I'm pleased to report so far, our customers have demonstrated pricing resilience. We added Master Electronics to our roster of distribution partners to expand our customer base for our world-class products and solutions. We also amended and strengthened our partnership with VPS that cements our position as the exclusive provider of ICE technology, hardware, when awareness of software-defined power solutions is just taking off. A proof-of-concept initiated as SAP's COIL lab serves as a confirmation by a market leader of the ICE platform's innovative approach to data center power utilization.

In our Energy segment, we made the strategic decision to go global and we have great technology. And to fully capitalize on this technology, we looked for a partner with the business development and sales coverage to bring our gas technology solutions into more Energy markets, and in front of more decision-makers. The optimal partner for us is Samson AG. Samson's reputation in the Energy industry is peerless, and our partnership is borne off a shared belief that innovation and intelligence grounded in disruptive technologies are imperatives for energy operators today, as gas becomes an increasingly important component of the global Energy mix. Samson's sales force across key geographies, such as China, Russia and others, is now up to speed on our GasPT. We have conducted multiple joint presentations and industry events as part of our business development strategy to drive awareness and adoption of the GasPT globally. I cannot be more pleased with how this partnership has proceeded. I'll have more to say on this relationship as well after Dan's review.

And finally, in the U.K., securing Ofgem certification of the GasPT in 2018 not only opened the entire market to our solution for Biomethane, low-pressure off-takes and high-pressure intake applications, but also opened the U.K.'s Future Billing Methodology or FBM project to us, and now represents our largest opportunity for the Energy segment.

In U.K., FBM would require a smaller form factor and less expensive GasPT with potential unit sales of between 5,000 and 45,000 units. Formal trials of the FBM solutions were scheduled to begin before year-end with a go live for testing in 2019 or early 2020. Due to a sensor issue not related to us, trials have been delayed by about 1 year as the project addresses required rework. This then means that Ofgem and the U.K. government are now planning to roll out FBM sometime later in 2020. While disappointed by delay, we remain committed to supporting this long-term opportunity.

In short, we are not standing still while we wait for work on our Italian contract to resume. On that note, we were recently informed by our Italian distributor that the Italian energy regulator has published an official report stating that a quality analyzer is mandated on all off-takes of a certain size or larger for the new Energy tariff period 2020 to 2025. There's only one gas analyzer spec to the customers' requirements and that is our GasPT. So while this is the step forward we are all waiting for, the report tells us that the GasPT is a component of the Energy regulator's new tariff scheme, and reinforces our belief that fulfillment of the contract isn't a matter of if, but of when. Now let me turn the call over to Dan who will take you through his review of our financials. Dan?

- **Daniel N. Ford - CUI Global, Inc. – Chief Financial Officer**

Thank you, Bill. Before I review our 2018 fourth quarter and full year results, let me remind you that CUI Global has adopted the new revenue accounting standard known as ASC Topic 606 for fiscal year 2018. All financials presented today as well as those found in the PowerPoint presentation that accompanies this call are based on these new revenue rules, unless otherwise stated.

As such, our financial results for the fourth quarter are not directly comparable to those of the year-ago period that were reported under the old revenue rules. To give you an apples-to-apples comparison, we are also providing both our fourth quarter and full-year results for 2018 as reported under the old revenue rules compared to 2017. You can find this table on Slide 4 in the PowerPoint presentation. Also, note 2 of our consolidated financial statements in our Form 10-K for the year ended December 31, 2018, gives you a detailed explanation of revenue recognition under both the old and new rules and its cumulative effect on our results.

Starting with our consolidated results for the fourth quarter, total revenue was $27 million, an increase of 28% from $21.1 million for the fourth quarter 2017. The increase is attributable to revenue increases in both the Power and Electromechanical and Energy segments due to the timing of customer project delivery schedules and higher sales through our distribution customers in the Power and Electromechanical segment, coupled with improved integration revenue in Energy segment.

Improvements in Energy segment were despite the continued lower than forecasted sales of GasPT related to shipment delays on a significant project in Italy. Consolidated gross profit was essentially flat at $6.4 million, although gross profit margin declined to 23.9% from 30.9% last year.

The decrease in gross profit margin reflects a higher contribution of lower margin revenue in Energy segment, partially offset by improved margins in the Power and Electromechanical segment. Also contributing to the lower margin for the fourth quarter, we recorded a $1.5 million write-down of deposits in other assets, and a $1.4 million increase to inventory reserves, both of which reflects lower than anticipated revenue growth in our Orbital-UK subsidiary. Exclusive of those two items, the gross profit margin for the fourth quarter was $9.3 million or 35%.

Consolidated selling, general and administrative expenses for the fourth quarter were $9.4 million, an increase of $1 million or 11.3% compared to the prior year Q4, reflecting higher revenues in both segments. While SG&A expenses increased in absolute dollar terms as a percentage of revenue, SG&A declined to 35% of revenue from 40% in the year ago period.

Adjusted EBITDA loss for the fourth quarter of $2.1 million improved compared to a loss of $2.3 million in the year ago period. For the fourth quarter, we recorded a $3.1 million goodwill impairment charge associated with our Orbital-UK subsidiary, reflecting slower than anticipated revenue growth and delays associated with existing customer contracts that have not yet resumed in our Energy segment.

We test for goodwill impairment in the second quarter of each year and when events or circumstances indicate that the carrying amount of goodwill exceeds its fair value and may not be recoverable. With the impairment of goodwill recorded in the fourth quarter of 2018, we have fully written off the goodwill related to Orbital-UK. Including the goodwill impairment charge, the write down of deposits and other assets, and increased inventory reserves, net loss for the quarter was $7.8 million or $0.27 per share compared to a net loss of $5.3 million or $0.20 per share for the same period last year.

Our adjusted net loss, which excludes goodwill impairment charges and the write down of our deposits and other assets, but not the inventory reserve adjustment, was a loss of $2.8 million for the quarter. The full calculation of our adjusted net loss is included with our earnings release.

Additionally, in accordance with U.S. GAAP, for sale and lease-back transactions and effect for fiscal year 2018, the company did not recognize the $2.9 million gain on the sale of our Oregon headquarters facility during the fourth quarter.

Turning to our segment revenue and gross margin. I'll start with our Power and Electromechanical segment. Revenues for the quarter were $19.5 million compared to $15.9 million last year, an increase of 23%. This increase reflects strength in the business as revenue typically troughs in Q4 and peaks in Q2 and Q3. In this fourth quarter, we also saw a $0.7 million increase to revenues from the impact of tariffs on the importation of electronic components from China, as a cost of tariffs were passed on to our customers through higher prices, which offset the related cost of revenues increase. Gross profit for the fourth quarter was $6.9 million or 36%, an increase in gross profit percentage on higher revenues compared to 33% gross profit percentage in the fourth quarter of 2017, reflecting an improved product mix.

Our Energy segment produced revenues of $7.4 million and well above last year when reported revenue of $5.2 million. As I noted earlier, the year-over-year variance reflects the time difference from project schedules. The U.K. market was generally slower than projected in 2018 due to lower than forecasted sales of higher-margin GasPTs. Revenues for the quarter were almost entirely weighted towards lower margin integration projects, including Biomethane integrated award secured over the course of the year.

As mentioned previously, we recorded a $1.5 million write down of deposits and other assets, and a $1.4 million increased inventory reserves, both of which reflects lower than anticipated revenue growth in our Orbital-UK subsidiary. Exclusive of those 2 items, the gross profit margin for the fourth quarter was $2.4 million or 33%.

As a result of lower margin integration projects in these items, gross margin for the quarter was negative 6.6% compared with 23.3% last year. Exclusive of the impairments, the deposits and other assets, and large increase in the inventory reserve, the gross margin for the quarter would've been 32.6%. As a reminder, our Energy segment experiences improved margins when it sells more of its leading technology solutions, including GasPT and VE sampling systems and with more through-put of integration projects in our facilities resulting in operational efficiencies. For the year, consolidated revenue increased $13.5 million to $96.8 million from $83.3 million. The improvement in total revenue was driven almost exclusively by our Power and Electromechanical segment that benefited from higher sales for distribution customers and the adoption of Topic 606.

Energy segment increased slightly for the reasons I noted related to this segment's fourth quarter 2018 performance. Consolidated gross profit increased for the year by $1 million to $28.9 million compared to $27.9 million in the prior year period. Although, consolidated gross profit margin declined to 29.9% gross profit margin compared to 33.5% over the same time period due to a higher contribution of lower margin revenue from Energy segment and the $2.9 million in total write-downs, included in cost of revenue and the inventory reserves, which I discussed in the fourth quarter review.

Also note that we had approximately $1.3 million of VPS sales in 2018 that were subject to a 100% royalty under the terms of the royalty agreement, without which the gross margin would've considerably improved. As discussed on previous conference calls, the first $1.4 million of sales were at the 100% license rate, after which the rate would be normalized.

Consolidated SG&A expenses for the year were $36.3 million, a $2.4 million increase, primarily due to higher selling expenses on the higher sales within both segments, higher professional fees in Energy segment, and higher SG&A expenses of new Houston facility and higher marketing expenses. While SG&A expenses increased in absolute dollar terms as a percentage of revenue, SG&A decreased 3 percentage of revenue for the year to 38%. EBITDA loss for the year was

$14 million compared to $10.8 million in the prior year period. Adjusted EBITDA loss for the year was $8 million compared to $7.4 million in the prior year period. During 2018, we recorded a total of $4.3 million of impairment to goodwill in addition to $1.5 million impairment to deposits and other assets at Orbital-UK. Including these impairment charges, net loss for the year was $17.3 million or $0.61 per share compared to a net loss of $12.6 million or $0.56 per share in the prior year.

Consolidated backlog increased to $37.5 million at year-end compared to $32.8 million at December 31, 2017, an increase of $4.7 million. Backlog for the Power and Electromechanical segment was $21.8 million, representing a slight increase compared to $20.2 million at December 31, 2017. And attributable to continued strong ordering performance and through-put within our channels.

The Energy segment backlog at year-end increased $3.1 million to $15.7 million compared to $12.6 million at December 31, 2017, reflecting increases in integration backlog in both the U.K. and North America. In terms of our balance sheet, we ended the quarter with cash, cash equivalents and restricted cash of $4.5 million, this compares to $12.6 million as of December 31, 2017. Supplementing our cash balances, we completed the sale and leaseback of our Tualatin facility in December, which generated net proceeds of $4.2 million after expenses, the payoff of the mortgage note payable and related interest rate swap derivative.

To further supplement our cash balances with the filing of our 10-K today, we are providing details of a firm commitment from Bank of America Merrill Lynch on a revolving line of credit of up to $10 million. Securing this line of credit, which is expected to close by April 30, further demonstrates our commitments to securing non-dilutive sources of capital. The new credit facility will replace our existing U.S. based revolver facility and U.K. based overdraft facility with more favorable terms and increased capacity.

Finally, with our announcement this morning, we've also secured an approximate 20% equity interest in Virtual Power Systems, which Bill will discuss further in his remarks. In exchange for the equity interest, CUI will invest another $345,000 into VPS, convert its $655,000 of convertible notes receivable to equity, contribute ICE-related inventory lab equipment certifications, intellectual property and other related assets into VPS. In conjunction with the equity position, CUI will receive a board seat and place an observational non-voting adviser to the VPS board.

After closing this transaction, we expect record results of VPS using the equity method of accounting. That concludes my prepared remarks. I will now turn the call back to Bill.

- **William J. Clough - CUI Global, Inc. - Chairman, CEO, President & General Counsel**

Thank you, Dan. Looking ahead to the balance of 2019, we remain focused on developing Energy segment opportunities while sustaining our Power and Electromechanical segment performance. By developing business with new customers, expanding existing customer relationships and introducing new products, we expect to sustain the Power and Electromechanical segment's revenue trajectory.

Innovation is also a core tenet of this segment, and our new equity interest in VPS is a natural extension of our strong working partnership with VPS and its management. Since the formalization of our amended agreement last year, we have come to appreciate the enormous untapped market potential of VPS software-defined power platform when applied to other areas in a data center, compute, storage, networking resources and enabling the next generation of software-defined data centers. As Dan explained, we have agreed to terms with VPS for approximately 20% equity interests. In effect, while we remain the exclusive manufacturer of the ICE Switch and ICE Block for VPS, we now have the ability to participate more broadly through our equity position in VPS on its far-reaching applications of software-defined power, and thus, participate in VPS' future profitability.

VPS envisions that 2019 will be the year that proof-of-concept testing that several large customers complete and will turn into orders. In our Energy segment, the U.K. public utility sector spending freeze has shown signs of thawing. Last fall, we signed a 2-year $1.5 million services contract with a major gas transmission company. Just prior to that, we signed a framework agreement with Cadent Gas, the U.K.s largest gas distribution network to bring Biomethane onto its distribution network, an opportunity catalyzed both by the RHI and expectations for increased CapEx spending.

As the pace of moving the global Energy mix towards less carbon intensive sources quickens, we have positioned our gas technology solutions to take advantage of the shift towards natural gas and renewable natural gases or RNGs such as Biomethane and we are taking our place on the international Biomethane stage.

We were recently invited to attend a closed-door event of stakeholders with major gas networks and national labs, with the intent of setting national and international standards for measurement requirements for Biomethane use. From that event, we developed sales leads and are registering Orbital as an established provider of Biomethane integrated solutions in Italy, Spain and France to follow through on those leads. We are also seeing interest from regulators in California, which, despite the U.S. withdrawal from the Paris Accord, has committed to meet the Accord's call for 25% reduction in greenhouse gas emissions by 2025.

California will incent increased production and usage of RNG through tax credits. To that end, the state is preparing a bake-off in which they will select preferred vendors. As in other Biomethane markets, we have a significant competitive advantage because we can offer an integrated turnkey solution that includes the GasPT. No one else can meet our performance metrics at our price point. Staying in the U.S. and turning to our new Orbital facility in Houston, this facility should build on its 2018 revenue and approach breakeven in 2019. This facility is working on several large projects for Fortune 100 Energy companies throughout the U.S. and is seeing a pipeline that is growing both in volume and average contract size.

Given its proximity to the Energy epicenter of North America, our use of facility will be a key component in our North American strategy in 2019 and beyond. Our efforts extend also north of the border to Canada, where 4 of our GasPTs have been undergoing field trials with a major transmission company and a utility company to ensure device functionality in the depths of winter, which is a key consideration for Canadian operators. The utility company is now on a path to deploying additional units sometime midyear.

Data collected from the utilities units will support our certification process with Measurement Canada. Certification is expected in the very near future. Staying with GasPT, though for process control applications, we are now one technical meeting away from securing certification from our turbine manufacturer partner. No date is set yet for the technical meeting. With this certification, our GasPT will be included on the manufacturer's bill of materials for new turbines, thereby, giving us a path forward to a broader retrofit opportunity.

To that end, we now have a line of sight into a limited deployment of GasPTs on the turbines of a large Midwest utility company. We are bearing the fruits of our joint marketing efforts with Samson. Three industrial customers in Western Europe have expressed a very strong interest in starting field trials for the GasPTi. Additional sales increase from Germany, China, Singapore and Colombia are also being pursued. We are especially pleased with inroads made in China and now in South America. We will be rolling out additional technical training through Samson in South America to support that untapped geography as well as in South Korea. The pipeline of opportunity is growing and we are very pleased with this partnership.

While we execute on opportunities before us, we are also casting a wide net to create new markets for our gas technology solutions. We are planning to publish a white paper in collaboration with a global energy operator soon that demonstrates the versatility of our GasPT and has opened a new market for us.

To summarize this new opportunity for you, our engineers have collaborated with DNV GL from whom we licensed GasPT to apply a new algorithm to GasPT that makes the analyzer broadly applicable to marine market. The marine tanker industry is switching from oil derivatives to LNG as a fuel for tankers. Specifically in the case of LNG tankers, boil-off gas is used to fuel their engines. This makes GasPT with a new algorithm a natural fit for the retrofit market because CB content of the boil-off gas that is used for propulsion has to meet a specific range, otherwise bad gas can destroy these large complex turbine engines. As you will recall, we already moved into marine market with Cryostar Group. However, adoption of the DNV GL algorithm makes our device even more broadly applicable across the marine market. As you can see, we are moving forward on a path to sustain revenue growth and profitability in our Power and Electromechanical business and on multiple paths for revenue optionality in our Energy segment that moves us closer to breakeven on a consolidated basis without relying on any single customer or project. At the same time, we are strengthening our balance sheet with non-dilutive capital by selling our Tualatin facility, and we have secured a firm commitment for a new larger line of direct credit from Bank of America. We remain committed to realizing the full extent of the opportunities afforded us by our technologies across our 2 business segments. Thank you for your time and attention today. Operator, please open the call to questions.

QUESTION AND ANSWERS

- **Operator:**

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

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

  May be on the turbine opportunity, just -- I know that the process with this potential partner has taken quite a while. Can you just go a little more in depth, I missed the details, on what the next steps are, and may be confidence that you have that it actually is a near-term event and not something that drifts to the right?

- **William J. Clough - CUI Global, Inc. - Chairman, CEO, President & General Counsel**

  Yes, obviously, dealing with the large customer like this you can never be sure of what's going on, but they did have a very long term test procedure, as you know, part of that test procedure had a problem because of the gas was being provided to the device. We have now had technical meeting, several, to resolve that issue. It's our understanding that now that issue has been resolved, we will be meeting with them in near-term to finalize certification. We -- it's our understanding that they do not have to continue any more testing that they simply have to agree that our solution and the issue that arose was what we have said it was. And again, we're very comfortable with what we've given to them and feel quite confident that this next meeting will result in moving forward. They have become very eager to move forward because of some issues they've had with their machines.

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

  Got it, okay. Maybe just turning to Italy, you mentioned that the Snam had published a report talking about 2020 to 2025. I mean does that – I know you're not going to call and I wouldn't ask you to try to call timing of deployments. But, I mean, does that give you any insight into what the thought process is that may be more optimism that it could start in 2019 or is it something

- **William J. Clough - CUI Global, Inc. - Chairman, CEO, President & General Counsel**

  I think the tariff scheme indicates that they will have devices deployed across certain size off-takes in conjunction with that 2020 to 2025 tariff plan. The schematics were produced with that plan. And on the schematics, our analyzers clearly identified. So it is something we're -- this doesn't tell us when they'll restart the program, but it certainly says that, that plan -- their plan from 2020 to 2025 includes monitoring by our machines. So while we haven't any indication as to when they will start deployment, we certainly feel this makes it, again, not a question of if, it's a question of when.

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

  Got it. Okay. And then last one from me, just to clarify SAP and the COIL lab testing, is that still in process? I know previously you thought that would be a 3- to 6-month time frame for that in that unit, then after that, you'd have better clarity on what the overall opportunity is.

- **William J. Clough - CUI Global, Inc. - Chairman, CEO, President & General Counsel**

  Yes, it's still in process and again, with most customers of that size, it's really in their hands at this point. They seem to be happy with what's been happening so far. But again, we won't know, when they're complete with that until they are ready to tell us that.

- **Operator:**

  (Operator Instructions)

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

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

  Just wanted to get a little further color on the VPS deal. Does this mean the ICE Block -- I guess, just help me understand what the ICE Block revenue will do, will that still flow through your earnings and your P&L and then rest of the VPS activity will be an equity interest? Or just help me understand how that works?

- **Daniel N. Ford - CUI Global, Inc. – Chief Financial Officer**

  Sure. So we will be the manufacturer for VPS for those technologies, but they will recognize the lion share of revenue on that. We will recognize more of a manufacturing type margin on that. What this is doing is essentially is providing a whole lot of synergy from a marketing, engineering and sales standpoint to go to market under one umbrella with VPS and with their software controlling it. Not being a competitor from some of the other companies that they are working with, licensing the technology into and really becoming one partnership. So what it does for us is they have a captive facility for manufacturing. It's going to give us improved efficiencies from operating costs and standpoint at our factory, keeping the factory full. But our upside is on their success. And we actually feel that through this equity interest now we are not limited to just the success of the ICE hardware that we manufacture, but we now are participant in VPS' overall success, including on the subscription software that they have on the software-defined power front. So from that standpoint -- that's why we went with it. It's a synergistic opportunity for both companies to get to market faster and better, and aligns our goals together.

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

  And then on the future billing methodology, U.K. opportunities, talking about some timing shifts there. What terms -- maybe some further color on that and when do you expect revenue to flow?

- **William J. Clough - CUI Global, Inc. - Chairman, CEO, President & General Counsel**

  We'll still see some revenue this year. It's just that the full-on testing won't begin until 2020. I mean, it's a sensor issue that they had, that has nothing to do with us. But because the sensor was not able to perform the way they wanted it to, we had to redesign another sensor to put into it and that's just simply delayed the project. Now we'll still be rolling out the initial test units, we believe, later this year. Those are 44 units that are already prepared and ready to go, but I think it just sets back the implementation of the project for about 12 months.

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

  And then the Energy business, I think you talked about Q4 being a seasonal long period. And yes, it was a good quarter. Do you expect that to continue to ramp from this kind of level in the '19? Or is there some shifting around you expect there?

- **William J. Clough - CUI Global, Inc. - Chairman, CEO, President & General Counsel**

  No. We expect that to continue to ramp. The RHI is now in full swing. Again, as with any governmental entity in Europe and elsewhere, there's always going to be ups and downs with it, but we have now a couple of larger clients. One in particular, who is beginning to move forward on projects, even without the RHI subsidy. So we think that we'll see a continued growth in the Energy sector. We're also seeing some nice growth in North America, our Houston facility has gotten some really nice contracts from some very large Fortune 100 energy companies. We expect to see that to continue as well.

- **Operator:**

  Thank you, ladies and gentlemen. That does conclude our question-and-answer session for today. I would like to turn the call back over to William Clough for any closing remarks.

- **William J. Clough - CUI Global, Inc. - Chairman, CEO, President & General Counsel**

  Thank you operator. Thank you, as always, everyone for joining us today. We will be speaking with you again next quarter. And again, thank you.

- **Operator:**

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