CUI GLOBAL, INC. THIRD QUARTER 2015 EARNINGS CONFERENCE CALL TRANSCRIPT

November 10, 2015
9:00 a.m. ET

Operator: Good day, ladies and gentlemen, and welcome to the CUI Global Third Quarter 2015 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time. If anyone should require assistance, please press star then zero on your touch-tone telephone. As a reminder, this conference is being recorded.

I would now turn the call over to your host, Janine Zanelli. Please go ahead.

Janine Zanelli: Thank you and good morning. Welcome to the CUI Global's 2015 third quarter earnings conference call. We appreciate you joining us today. With me on the call is Mr. Bill Clough, Chief Executive Officer; and Dan Ford, Chief Financial Officer.

The purpose of today's call is to review the company's financial results for the third quarter, as well as provide you with some additional color on the business going forward. Following management's remarks, the call will be opened up for questions.

Many of you may have seen the company's release that was issued yesterday. If you haven't, it can be accessed at the company's website at www.cuiglobal.com. A replay of this call will be available until November 21st; details can be found in the press release. Today, during the course of the presentation, we will be directing your attention to a series of slides. Those slides can be accessed during the call from the link in the press release that went out yesterday or from the Investor Relations section of the website.

As a reminder, this call will contain certain forward-looking statements 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.

On Slide 2, we discussed the forward-looking statements. 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, our reliance on third-party manufacturers and suppliers, the government agency budgetary and political constrains, 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.

With that, I'd like to introduce Mr. Bill Clough, CEO of CUI.

William Clough: Thank you, Janine, and thank you, everyone, for taking the time to join us on this morning's call. I'll start with a brief overview of the quarter, and then I'll hand the call over to Dan to review the third quarter and year-to-date financials in more detail. When Dan is finished with his remarks, I'll provide some additional commentary on several of the key initiatives we are working on CUI Global. We'll open the call up to Q&A after that.

As discussed during the second quarter conference call, due to the type and size of contracts we currently engage in and market conditions, we have adopted a policy to not identify parties we were selling to by name. Occasionally, you may see an announcement from CUI identifying a substantive of sales win or partnership; but in the regular course of business we will not share company names. We appreciate your understanding of this practice, which will benefit our customers and CUI and we believe it will actually allow us to be more informative in our public announcements.

Turning to the quarterly results, there is positive momentum in CUI's business supported by a strong third quarter. Revenues for the third quarter were $24.9 million, an increase of 17 percent compared to the prior year. From a segment perspective, quarterly revenues for the Power and Electro-Mechanical segment contributed $16.7 million, an increase of 29 percent from third quarter 2014; and the Gas segment contributed $8.2 million, a 2 percent decrease from the prior year.

For the nine months ended, revenues were $64.8 million, an increase of 13 percent compared to the prior year. The Power and Electro-Mechanical segment contributed $44 million of revenue during the nine-months ended, an 18 percent increase over the prior year; while the Gas segment contributed $20.7 million of revenue, an increase of 3 percent from the prior year.

Backlog is strong for both business segments representing $38.8 million of open customer orders as of September 30, which makes us quite optimistic as we look ahead.

The Power and Electro-Mechanical segment, which represented 67 percent of the revenues in third quarter, showed positive revenue growth both year-over-year and sequential. A significant portion of that increase is associated with the sales performance of power technology products acquired in the March 2015, from Tectrol. Following that acquisition, we estimated those acquired power technology products would add an incremental $10 million to $12 million in revenue to the P&E segment in fiscal year 2015. Today, we share with you that through September 30, those products have already generated $10.4 million of revenues as the product buying has integrated very well with CUI's existing Power and Electro-Mechanical segment sales platform.

The Gas segment, representing 33 percent of revenue, showed positive sequential growth and a small decrease in revenue from the third quarter of 2014. We continue to see traction develop in both the VE and GasPT technologies,   significant progress in trace element detection and an uptick with some significant customers. In particular, our ability to quickly and accurately detect mercury is becoming more and more recognized in the industry. Because mercury is highly corrosive to aluminum and therefore can create catastrophic damage to LNG terminals, we've been very aggressive in that market, and we are seeing significant results in Australia and elsewhere.

Our integration efforts with CUI Canada continue. This acquisition has already enhanced capabilities of our power group and has broadened the customer base for our proprietary electronic product line. We continue to analyze our ability to manufacture more of our product line in Canada.

Let me turn the microphone over to Dan Ford, our CFO, so he can run through the numbers in more detail. Dan?

Daniel Ford: Thank you, Bill. I'll discuss not only our third quarter results but also the year-to-date 2015 as well.

As Bill mentioned, the company's revenues were $24.9 million for the quarter, up 17 percent from the third quarter of 2014. Year-to-date revenues were $64.8 million, up 13 percent from the first nine months of 2014.

The cost of revenues for the quarter was $15.5 million versus $13.4 million in the same period last year. Cost of revenues as a percentage of revenue for the three months ended September 30, 2015 improved slightly to 62 percent from 63 percent during the prior-year comparative period.

For the year-to-date period ended September 30, cost of revenues was $40.8 million versus $34.8 million for the comparable period in 2014. The cost of revenue as a percentage of revenue for the year-to-date period increased to 63 percent from 60 percent during the prior-year comparable period. The cost of revenues as a percentage of revenue will vary based upon the product mix sold during the period, the mix of natural gas systems sold during the period, contract labor necessary to complete gas-related projects, and is also dependent upon competitive markets in which the company competes as well as foreign exchange rates.

The company expects 2015 cost of revenues to remain in the low 60 percent of revenues range consistent with the past three fiscal years and resulting from consistent margins on core power segment products, lower margins on gas integration related projects, and higher margins on technology-based products offerings in both segments.

The unaudited sales order backlog at September 30, 2015 was a consolidated $38.8 million; of that the Power and Electro-Mechanical segment held an unaudited backlog of customer orders of approximately $23.5 million and the Gas segment held an unaudited backlog of approximately $15.3 million.

Gross profit for the quarter was consistent with the prior year quarter at 38 percent, generating $9.4 million of gross profit as compared to $8 million in the prior year period. For the year-to-date period, gross profit was $23.9 million or 37 percent versus $22.7 million or 40 percent during the prior year nine months ended.

During the three and nine months ended September30, the Power and Electro-Mechanical segment generated gross profit margins of 39 percent and 38 percent respectively, while the Gas segment generated gross profit margin of 35 percent for both periods.

Selling, general and administrative expenses increased by $1.1 million to $7.9 million for the third quarter compared to $6.8 million in the same period 2014. SG&A was flat at 32 percent as a percentage of revenues compared to the prior year. For the nine months ended September 30, SG&A increased by $5 million to $24.5 million versus $19.5 million during the prior year period and as a percentage of revenue it increased to 38 percent from 34 percent for the same comparable period.

The increases in SG&A costs for the three and nine months as compared to the prior year period are primarily associated with the increased sales volume of Power segment including the addition of the operations related to CUI-Canada. Also contributing to the increase in SG&A were SG&A activities of Orbital Gas Systems North America, which opened in January 2015. The remaining increases in SG&A are associated with the ongoing activities to reach new customers, promote new product lines including Novum, GasPT, IRIS, and VE-Probe, as well as new product introductions.

Partially offsetting the increase in the quarter and nine months was a $0.7 million charge during the three months ended September 30, 2014, of equity compensation expense for strategic consulting services that were completed regarding the testing and demonstration of the GasPT technology in accordance with the terms of a consulting agreement.

The company reported a net loss of $59,000 or 0 cents per share, EPS, for the quarter ended September 30, 2015. In the prior year period, the company reported a net loss of $349,000 or 2 cents per share.

For the nine months ended September 30, 2015, the company reported a net loss of $4.6 million or 22 cents per share as compared to the loss of $903,000 or 4 cents per share in the prior year period. The net loss for the three and nine months ended September 30, 2015, was primarily the result of increased selling, general, and administrative expenses related to the opening of the Orbital Gas Systems North America facility in January 2015 and the addition of CUI Canada in March 2015, as well as the ongoing amortization of intangible assets related to the Orbital Gas Systems Limited and CUI-Canada acquisitions.

Adjusted net income, which represents net income or loss plus the amortization expense of the intangible assets acquired via the 2013 Orbital acquisition and the 2015 CUI Canada acquisition, plus the expense associated with stock and options issued for compensation, royalties and services, for the third quarter was $506,000 or 2 cents per share as compared with net income of $1.4 million or 7 cents per share for the third quarter of 2014. Year-to-date adjusted net loss was $2.4 million or 12 cents per share as compared to net income of $3 million or 14 cents per share in 2014.

As of September 30, 2015, CUI Global held cash and cash equivalents of $6.2 million, a decrease of $5.5 million since December 31, 2014. The company had additional short-term investment of $0.5 million, a decrease of $10.7 million since December 31, 2014. Operating activities generated negative cash flow from operations of $7.2 million during the nine months ended September 30, 2015, much of which was utilized during the first six months of

2015 following the opening of Orbital Gas Systems North America and the acquisition of CUI Canada versus positive cash flow from operations of $1.2 million for the first nine months of 2014. The change in cash used in operations is primarily the result of the net loss for the nine months ended September 30, 2015, before non-cash expenses as well as changes in assets and liabilities, particularly the assets and liabilities associated with the activities of Orbital Gas Systems North America and CUI-Canada.

For the third quarter of 2015, the company used $277,000 of cash in operating activities as compared with the $6.9 million used during the first six months of 2015, which was significantly impacted by the changes in operating assets and liabilities following the Q1 acquisition of CUI Canada and the opening of Orbital Gas Systems North America. Further to the overall change in cash and cash equivalents, and short-term investments, the company utilized $4.3 million of those assets to fund the acquisition of CUI Canada as well to fund $4.4 million of investments in property and equipment including the construction of the new manufacturing and research facility at Orbital Gas Systems Ltd. in the U.K.

As of September 30, 2015, the company had 20,805,241 common shares outstanding.

EBITDA for the quarter was a profit of $587,000 or 3 cents per share versus a profit of $840,000 or 4 cents per share for the same quarter in 2014. EBITDA for the nine months ended September 30, 2015 was a loss of $2.3 million or 11 cents per share as compared to the profit of $2.4 million or 12 cents per share for the first nine months of 2014.

Adjusted EBITDA for the third quarter of 2015 was $953,000 or 5 cents per share versus $1.8 million or 9 cents per share for the third quarter of 2014. Adjusted EBITDA for the nine months of 2015 was a loss of $1.3 million or 6 cents per share versus $4 million of profit or 19 cents per share for the first nine months of 2014. The EBITDA and adjusted EBITDA were primarily impacted by the previously discussed items regarding operating costs associated with launching Orbital Gas System North America.

Now, I will turn the call back to Bill.

William Clough: Thank you, Dan. Before we take questions, let’s talk in more detail about some of our recent accomplishments.

In the third quarter, we continue to see increased demand and interest in our GasPT and VE Technology products lines. We delivered and received purchase orders for seven GasPTi's. Significantly on September 3rd, we received the long-awaited request for quote from a large Italian pipeline transmission company for as many as 3,000 GasPT units. A response to that RFQ was due late last month and was filed in a timely manner. While there is a little to say about the project at this point, we expect some news before the end of the year.

Additionally, we delivered two redundant GasPTi systems to a large Asian natural gas operator and manufacturer. These units are part of a pilot program to determine a potentially much broader deployment of the technology by this customer for process control of its large-frame power generation turbines worldwide. Our GasPT products are now being tested and evaluated by two of the world's leading manufacturers of gas turbines, which represent one of the largest addressable market opportunities for us in terms of both new builds and the thousands of existing units in operation around the world.

From process control for large natural gas-fired turbines and compressors, to Mercury detection, to thermal well applications, and trace element detection like moisture, our new technology portfolio is increasingly recognized as a unique, cost effective solution for many challenges facing the natural gas industry, providing operators with information, efficiencies, and real time data, which is simply unavailable by any other means.

With that fact in mind, let's move to the VE Technology sales, where the news is also quite positive. In the third quarter, we delivered an additional four VE sampling systems, bringing our total delivered units to 112 units, while we delivered an additional seven VE thermal well applications, bringing the total deliveries of thermal wells to 419 units.

Furthermore, we have outstanding purchase orders for GasPT, GasPTi, and VE sampling systems, representing more than GBP2 million or $3 million in revenues. We continue to receive increase and are working with numerous potential customers.

Additional highlights from our third quarter include -- we received a long-awaited request for quote from a large Italian pipeline transmission company for as many as 3,000 GasPT units with initial deliveries beginning in early 2016; we delivered our initial Mercury sensor devices, incorporating the company's proprietary VE Technology to the Gorgon LNG project in Queensland, Australia; we delivered 11 additional VE Probe/Sampling/Spare systems; we delivered and/or received purchase orders for an additional seven GasPTi's; we successfully were awarded four additional bio-methane orders; we received purchase orders from a large U.K. natural gas transmission company for 10 additional IRIS kiosk; we received the 2015 M&A Award for U.S. Manufacturing Acquisition of the Year from Acquisition International, a well-respected European periodical, for acquisition of Tectrol, now CUI-Canada; we announced the appointment of an experienced oil & gas executive, Joseph A. Mills, as an independent director of the company; and we formally opened our new 46,000-square-foot Manufacturing/R&D Facility at our U.K. headquarters in Staffordshire near Stone.

In conclusion, we're pleased not only with our solid third quarter performance, but also with our strong backlog, continued interest and traction with our new technology from a growing number of companies, as well as our initial interaction with customers about our new product portfolio acquired from CUI Canada, all of which bode well for continuing momentum into the current quarter and into 2016.

We are quite satisfied with our third quarter performance. And while we understand the near-term focus many shareholders have on our opportunity with the Italian natural gas transmission company, it is important for everyone to understand that we have made significant progress with many other large global companies in the natural gas industry, and that the future and the prosperity of CUI Global and its subsidiaries is not tied to any individual customer or project.

Finally, I'd like to thank everyone for your continued interest and support of CUI. Now let's open the floor for questions.

Operator: Thank you. Ladies and gentlemen, to ask a question, please press star then one on your touch-tone telephone. If your question has been answered and you wish to remove yourself from the queue, you may press the pound key.

Our first question comes from Joe Maxa with Dougherty & Company. Your line is open.

Joseph Maxa: Thank you and congrats on a nice quarter. So, question on the opportunity with the large Italian gas company. You mentioned you may hear something by yearend, or would you expect that to be some type of order by yearend? Or is there another step you need?

William Clough: It's hard for me to. There's no other step that we need. We have already received a couple of inquiries regarding the bid that we submitted. So they are actively reviewing it. I just expect to hear something that we can announce by the end of the year. But, again, I have nothing on which to base that other than historically, they generally take 30 to 45 days to make these decisions after the requests are filed, and we filed our bid on the 29th of October.

Joseph Maxa: OK, that's helpful. On the backlog, obviously solid backlog in the Power segment; the backlog in the Gas segment was down little bit sequentially. But excluded any other, you know, maybe orders from, let’s say, the large gas Italian company, would you expect that gas products or let’s say the Gas segment to increase sequentially in Q4?

William Clough: Yes, I would think so. Again, especially the backlog, it's nothing particularly exciting. It's simply seasonal up and down of the business. So there was nothing particular. Yes, there are a couple of events happening that could actually dramatically affect that outside of Italy. There is a decision going to be made at the end of this month by the British Government, as to whether or not they will extend the tariff subsidies for bio-methane gas. If that happens, which we expect it will, that will dramatically change the number of bio-methane projects we'll probably be doing. So, again, there are a number of different things going on, but there's nothing in particular exciting about that, it's just seasonal.

Joseph Maxa: And speaking of the bio-methane gas, those skids have, has that margin improved meaningfully from where you were seeing before?

William Clough: Yes, absolutely. Two things we've done. One is, nothing in too much detail, but we had been providing the market with what refer to as kind of the Rolls Royce solution, and one of the things that we've done over the last several months, especially this last quarter, is we provided a much more stripped down model that has a much better margin. It's a lower top-end cost but better margin for us attacking – I was about to say Volkswagen version but I'm not going to say that now. Let me make it a Toyota version of the bio-methane skid that we're planning the market to be quite excited about. And so again, the margins are improving.

Daniel Ford: And I think you can see that Joe, too, just when you look back at Q4 of last year was when those margins were in the gutter, and the margin for the Gas segment was, I believe, low teens or just between 10 percent and 15 percent, somewhere in that range. And this quarter, it's in the mid 30s again. And that's where the fair amount of bio-methane project happens. So, the margins we are seeing are in the mid-30s on those bio skids.

Joseph Maxa: Right. And lastly I'll just ask on those mercury sensors. What type of margin do you see on that type of product line?

William Clough: Much the same as we do in GasPTi's; the substantial gross margin, very nice operating margin, something in the 30 percent, 35 percent range. So they are nice margin devices. Right now, you know, it's a situation where we have really the only response to mercury. Mercury is a really difficult element to detect because it's so heavy and settles to the bottom of whatever it's in. And so we've got a real lock in that market, that's why we're going after it so aggressively.

Joseph Maxa: Thank you very much.

Daniel Ford: Thanks, Joe.

William Clough: Thank you, Joe.

Operator: Our next question comes from Eric Stine with Craig-Hallum. Your line is open.

Eric Stine: Hi, Bill and Dan.

Daniel Ford: Hey, Eric, good morning.

William Clough: Hey, Eric.

Eric Stine: Good morning. Just wondering if you could just talk about the importance of what you're seeing now that you've got reference customers. We've always heard feedback that there is high interest in a lot of your gas products. But people really wanted to be able to talk to or see deployments that were actually in the field. So, I mean, what has that done to your pipeline and maybe what's that done for your distributors, and what kind of visibility does that give you going forward?

William Clough: Yes, we still haven't had the impact on our distributors or visibility that we hope and expect it will have as we go forward. But what we're starting to see and I think we've talked, you and I especially have talked about this, it is – the company is at an inflection point. We're now starting to see some major customers start to adopt the technology. We're just seeing the beginning of that. But it's not testing, it's not looking to see if it works, it's none of that. They're actually starting to adopt it, so they're starting to roll it out in the field.

As that happens, we're quite confident that those customers, while they're adamant about us not releasing press releases or anything like that, they are very willing to talk to other potential customers. And so, we think that this will be a big step forward in starting to see this technology adopted. The good news is the technology absolutely works. The better news is there is still no competing technology anywhere near us as of this point. Nothing that we are aware of that all, and we would be aware because of the certifications, and such, the technology would have to go through.

So now it's a matter of just kind of grinding out, you know, getting in front of people and getting those reference customers to talk to the right people, and that's what we're really doing. I think we're focusing now this year and in the next year on North America, and then depending on what happens in Italy, you know, we'll be focusing on Western Europe and [rolling it out] across Western Europe.

Eric Stine: Got it, OK, that's helpful. Maybe just turning to IRIS, any update on the RFP? I know that you've been getting orders from the transmission company there in the U.K., you know, kind of piecemeal orders working towards that larger order. Is that something that you expect, I mean 2016, but is there some timing you could share?

William Clough: You know, I wish I could. They've told us repeatedly. I mean we actually went to them a few months ago and said that we are going – if we didn't have some firm notices, what they were going do. We were going to take the resources that we have dedicated to the IRIS team, and IRIS team moved them somewhere else. That's when they started giving us these piecemeal orders and have told us unequivocally they do not want us to do that. They want us to keep that team together.

So, with that in mind, there is an order coming, I mean a bigger RFQ coming, but they just simply can't tell us when. They’ve got internal issues that they are going through. And, again, it's like anything else with budgetary issues. They’ve got their own people to answer to. But I will tell you that we have been told by them not to disband that team, to keep them together. They're still very committed to the technology.

Eric Stine: OK. And just to clarify something I've seen in the last few days some news out there that that transmission company might be selling their gas distribution assets. Would that – I mean does that have any impact on your outlook at all?

William Clough: No, actually distribution is a different matter for us. It's actually quite exciting for us. And we've talked about this in the past. We deal mostly with their transmission company, and the transmission is the big 48 inch pipelines. In Europe, the way it works and I think we've talked about this, is much like the human vein system. The transmission is being the big veins, 48-inch pipes that push a lot of gas through. Distribution is more like the capillary system. They are the ones who deliver directly to the customer. They deliver lower pressure gas, you know, two and three-inch pipelines; so very small.

There's a lot of demand especially for IRIS at the distribution levels especially for the IRIS light that we've talked about and noticed. So, distribution for us is a big deal. But, no, it really doesn't impact as who owns or what they do with it. It's just another customer for us. But we deal predominantly with our transmission group not with their distribution group.

Eric Stine: OK. Maybe last one from me, just on the Orbital, the new facility there, you know, just thoughts on how that helps your ability to respond as the potential Italy order in early first quarter.

William Clough: Yes, it's a big deal for us. I think as most people have been in the company for any length of time know the choke point for us on the GasPT is the calibration. It has to be calibrated once before it goes out in the field. The formal opening of this facility in the U.K. allows us to bring that all in house. We're going to be able to do all of our own calibration. We don't have to depend on outside third party contractors. We were having GL Noble Denton do it for us. We're bringing that in house, which means now we control our own destiny.

Frankly, if over the next couple of years, if things work out the way we hope it will, we want to bring that entire supply chain in house. We'll start doing the assembly and manufacturing in house as well. So, it is a situation where we're moving step-by-step to a point where we will be able to capture all the margin, manufacturing and other margin on this device, which we think will be that much better for the company. So it is, it’s controlling our own destiny, and that's what the new facility does.

It also allows us to bring everybody under one roof, which means when we have an issue, as an example in manufacturing, they could walk up stairs to talk to the engineers about design or design changes as opposed to having to drive somewhere and get on a telephone or do the other things that people tend to do. So everything is under one roof now. And I'd invite actually anybody who has the opportunity, if you get over to U.K. or on vacation or whatever and you like to stop by, we'd be happy to host you to. It is a beautiful facility, and I think it's going to really dramatically change the way we can deliver product.

Eric Stine: OK. Thanks a lot, guys.

William Clough: Thank you.

Operator: Our next question comes from Andrew D'Silva with Merriman Capital. Your line is open.

Andrew D'Silva: Hi, good morning, guys. Just a couple few questions for you here. As far as the large Italian operator goes, I remember previously we were expecting potential deadline to be in the summer of this year, and that got seemingly postponed six months or so. Are there any other delays that we can anticipate? Or are they like stuck on an affirmed deadline at this point in time?

William Clough: First of all, Andrew, let me disabuse of what you said. They have set a firm schedule, the first of this year, that they have never varied from. In the summer, what we had said – in the spring, rather, that they would issue an RFQ for prequalification of companies. They did that. They said that they would notify companies that could in fact bid in the summer. They did that. They said that they would issue an RFQ by the end of August, and I didn't believe that because Italians don't work in August, and that's just a fact, the country closes down. They issued that RFQ on September 3rd, so they were three days late on that. That's the only delay they've had.
They've told us that they will make a decision this year and that they expect units to be delivered first quarter of next year. They expect to install up to 650 units by June of next year.

So, none of this that's been announced earlier this year has slipped. It's been very definitive and very solid, and they've moved forward on that in that basis. So, you know, again, I can't tell you when and what they'll do. They are a semi-governmental agency that is the largest European utility company. So they are going to make decisions on their own time. But they have been very consistent over the schedules they put forward. And if they continue with that, we expect to hear something by the end of the year with, like I said, deliveries first quarter.

Andrew D'Silva: Great, great. Thank you for the clarity on that. And then as far as the need for that operator to have multiple technologies implemented, is there any sort of mandate in Italy as far as they'd have to use different contractors and different technologies so that they're not favoring anyone, particular one across the pipeline? Or is it possible that they could actually utilize a full 3,000 of your GasPT's?

William Clough: So, that's a grey area. I will tell you that the EU requires contracts of this size. And that's European Union. It's not Italy, it's the European Union. It's a very different situation over there. In fact, in some regards, you can almost liken it to the European countries being states in the United States, and they are now states in this European Union which is kind of hybrid entity. But the European Union requires contracts of this size to have bids go out that could be responded to by more than one vendor. They do not allow a bid like this to go out to more than one vendor.

On the other hand, there are qualifications that have to be made, safety certification, accuracy certifications, durability certifications; there's things that all vendors have to meet. And obviously, there are certain physical requirements regarding logistics; whether or not the device uses gas or needs to be calibrated or needs maintenance. So those are all things that the individual utilities able to take into account. I will tell you that the EU does not like to have single source contracts. On the other hand, there are plenty of single source contracts where you have unique technology or something that works differently than anything else on the market, and it's just not available anywhere else.

I can't begin to tell you what they're going to do at the end of the day. I can tell you what I know. And what I know is, right now, there are two companies they are looking at, us and our technology, and Elster and their technology. So those are the two companies they are looking at. They are not looking at anybody else. There is no other company that was invited to participate. So I know that, but I can't tell you who is going to get what.

Andrew D'Silva: OK. Got it. And as far as ASP goes to the IRIS kiosk, are they still GBP100,000 or is that a moving target, you know, currency fluctuation?

William Clough: No, the currency has been pretty stable at the U.K. So the pound is fairly stable, and yes, they're right around GBP100,000. We do have the IRIS light now, and substantially less, that's around GBP60,000. So again, there are two versions of it but it is consistent.

Andrew D'Silva: And with the large operator in the U.K., are they looking at the light version or not?

William Clough: They are looking at it. They are actually part of the group that's testing it right now. But what they've ordered are the regular standard IRIS kiosks.

Andrew D'Silva: Got it. And then you are working with the large organization in U.S. to gain distribution with IRIS domestically or at least in North America. Has there been any progress in that regard?

William Clough: No, we're still waiting frankly for the opportunity that we think is going to be there with ETP. As you're probably aware, and this is the one customer we will mention because it's specific, ETP has acquired Williams. They are now, at the end of the day, going to be the largest pipeline company in the U.S. and really the largest energy company, one of the largest energy companies in the world. And once that's done, we think we're going to have an opportunity to present to them. And that's really where our first initial presentation will be. And we have not made that presentation yet. We hope to do that if not late this fourth quarter, certainly the first part of 2016.

Andrew D'Silva: Alright. And a last question, as far as your distributors go, I think it was mentioned that you're getting right around the 40 distributor mark. Has there been any shift in distributors as far as the ones that you were working with? Have any of them fallen off and you've added new ones? Has there been any change there that you can indicate? Or has it been pretty consistent since the last call?

William Clough: Yes, real consistent, no changes at all. Again, we're early on in the distributor system, but no. Those that have been there, they are still there and there hasn't been any change. We have 42 and we're very satisfied with the network we have.

Andrew D'Silva: Alright. Hey, thanks a lot, guys. Good luck for the rest of the year.

William Clough: Thanks.

Operator: Our next question comes from Jim Kennedy with Marathon Capital Management. Your line is open.

James Kennedy: Hi, Bill. Hi, Dan.

William Clough: Hey, Jim, how are you? Thanks for the swag, by the way.

James Kennedy: Doing well. Hey, listen, I want to circle back to the mercury, the VE probes/sampling system. And could you attempt to size up the global market there number one? Number two, I assume at Gorgon, that was a new build. Is this also a retrofit technology for an LNG terminal that's already producing if you will? And if it is, what are they currently doing in the world of Mercury detection.

William Clough: Yes, I can tell you exactly what they are doing. They are not doing anything. In fact, Orbital put together a project for Norwegian company that had a fully loaded natural gas tanker turned away from North America because the North American operator said you can't certify that the Mercury content is low enough. We will not take this gas. And they had to turn around and go back with the fully loaded tanker full of natural gas, liquid natural gas. That company, as a matter of fact, is taking their entire terminal, their entire LNG terminal and retrofitting it with, not just our mercury sensors, but with our probes totally so they can do, in essence, detection of all microelements within the gas.

I don't have the global market for you, I can tell you that with these initial devices that we have sent down to Australia have been very successful. We are trying to do just develop that market. We're starting to get very aggressive with that customer and others. It is a very large market because obviously mercury is going to be a problem anywhere you're liquefying gas.

James Kennedy: OK. Could it be as simple as is taking the number of LNG terminals globally and of course one's being under construction now and assigning a certain dollar value to them?

William Clough: Yes, you could do that, although there are some gases that have, that don't have a mercury issue. There are Middle East terminals. For example, Qatar doesn't have mercury. It's not an issue down there. So there will be some of that. But it's – we just have not quantified that. I can't just give you off the top. It is a large market, there is no doubt about it.

James Kennedy: OK. And do you go to market simply by going to the terminal guys to the large integrated to the operator? I mean who is the actual purchaser? Do you have to get in to the design phase on a new build?

William Clough: All of the above. We're talking to a number of different big construction companies, design companies. We are using the company that we are dealing with now as a resource to go to co workers with there, the bottom line as you have Chevron, Shell, BP, all working on the Gorgon project together, so you have access to all of them through the relationship we're developing down there. And, again, you've got all of the things you mentioned we're doing. We've got people on the ground, going after this in every way possible.

James Kennedy: Got you. And is this specific to mercury? Or does the technology lend itself to detection of other things that have not been detectable in the past?

William Clough: It's not that they're not detectable, but it lends itself to any trace elements. And the reason that is and, again, not to get too technical, the VE Tech – the standard method of sampling gas is you pull up a whole lot of very dirty gas into a chamber, if you will, you filter that gas, and then you send it after it has been decompressed to a analyzer. The problem is that filtering and that the process of providing to the analyzer tends to make things blend. And as they blend trace elements disappear because you have more gas involved. So things like moisture, things like H2S, things like mercury disappear until they are so much of it that you can't just blend it out.

Our device, the VE Technology, because of the way it's operated takes a very small amount of gas with very little to no filtering and provides it from the center of the pipeline to the analyzer in a matter of seconds. So the gas sample that the analyzer gets is very pure, and it's exactly the gas is going through that pipeline. And because of that, the detection systems, which have always been good, detecting mercury, detecting H2S, detecting moisture, that is very simple. The problem is getting the right sample to the detector. And that's what we're doing – we are actually getting the sample that is truly representative of the gas to the analyzer. And that is what – frankly, that's what the industry is starting to see. They are starting to see that, what they thought was something that was just a normal part of the business which has taken a sample, who cares, who knows, that can't be very difficult. They are starting to realize, taking a sample is critical to trace element detection because if the sample is not pure, then you are not going to detect what is in that pipeline, you are going to detect a mixture that may or may not represent what's in pipeline.

James Kennedy: Very good, thanks.

Operator: Again, ladies and gentlemen, to ask a question, please press star then one on your touch-tone telephone.

Our next question comes from Gregory Macosko with Montrose Advisors. Your line is open.

Gregory Macosko: Yes, thank you. Just a follow-up on the mercury discussion. Is that only an LNG end market or are we talking distribution and like in the United States.

William Clough: It's predominately a LNG problem. It's predominately an issue when the gas is a liquefied. It's like moisture. Moisture – mercury gas – what happens in the standard pipeline if you're not liquefying it, it simply settles to the bottom of the pipe and you never see it, never hear about it. The problem when you liquefy it is you tighten everything up. As example, moisture is very, very difficult to deal with in a LNG terminal, because as you drop towards a 165-degree C below zero, that moisture becomes ice. And so the problem is obviously it can really do catastrophic damage to the LNG terminal.

So unless you're liquefying the gas, the trace elements really are not that important. In the standard pipeline, you've got – it's actually amazing. I never knew this until I got into the actual industry itself. But there is a whole bunch of real garbage that flows on the bottom of those pipelines. It really is – it is something that there's nothing that can be done about it. Natural gas is a natural product, and it does have additional elements to it. But once you go to liquefy it, that's where you have the problem because now you're concentrating it and you can cause real damage with these trace elements.

Gregory Macosko: Thanks for the explanation. And I did appreciate the explanation on the large distribution customer. All of that, Bill, that was good.

And finally, would you talk about – you mentioned Joe Mills. Just give me an some color on kind of what he is going to do, how that will change. Is that just a replacement or is that an expansion? Explain his position and what we expect to think?

William Clough: Sure. We're looking to, in essence, bring in people, industry people especially on to the board, we're going to be looking at people in the electronics industry as well as the gas industry, who can bring on two things -- one is, you know, business acumen and, sophistication to the board; and also a rolodex. Joe is a guy who's very respected in the industry. He has been in the industry for 30-plus years. He's run exploratory divisions within companies like El Paso Gas, he's run Eagle Rock Energy. He lives in Houston. He is very connected to the industry and brings to us a very high level of both credibility in the industry and also contact to the industry. He can take us to people that we wouldn't be able to get to. He can – by him being with us on our board, the industry looks at our company, I think, in a different light.

As an example, one of the things we're doing next year's. We're going to be attending a conference in Houston in the energy industry where he is going to host a dinner. He has got number of individuals who want to come to that dinner. He has an entire group of people that he thinks would be very interested in both the VE Technology and the GasPT. And he can bring that personal touch that without someone like that you just don't have.

So, again, I think he does two things for us -- one is a very sophisticated board member, a very adept and a respected business man; and he is in the industry which helps us. So like I say, we're going to be looking over the next months and the year or so for people like that both in gas and electronics.

And much like our acquisition strategy, we're trying to be very opportunistic. Obviously we want to pick people that are collegial and then will fit with our board. We're very proud of our current board. They've been – many of them long-term supporters of the company, and they have their own abilities that they bring to the table. We want people who fit with those people but also bring the additional value of being in the industry whether it'd be electronics or energy. Does that answer to your question?

Gregory Macosko: Thanks, Bill. Yes, thanks, Bill.

Operator: Our next question comes from James Liberman with Wells Fargo. Your line is open.

James Liberman: Greetings. Pleased to see the great progress you are making, Bill.

Daniel Ford: Thanks, Jim.

William Clough: Thank you.

James Liberman: Could you comment on the mercury monitor again? Is this something that is mandated or just simply good business practice for safe handling?

William Clough: It's not mandated because the problem is, there can be no mercury, in theory, n mercury in the LNG. And the reason for that is because, again, as I mentioned, it's highly corrosive to aluminum, and there is a lot of aluminum components in your LNG terminal whether it's export or import, it doesn't matter. So there is no level at which the mercury is acceptable.

The problem is up until the introduction of our technology, the sampling system, there was no true way to detect it on an accurate basis. And so what happened is you would have what happened with this Norwegian company. You have a source that is heavily, the people know is heavily contaminated with mercury. The LNG import terminal said we want certification that the Mercury level in this product you are trying to deliver us is either not there or very negligible, and they couldn't do it, they couldn't certify.

And so the North American LNG terminals said we were not taking it, take it away, we don't want it. So it's not a matter of good business practice, it's not a matter of regulatory control, it's a matter of if you can't certify we're not taking it because the problem is you take one tanker filled with gas that is contaminated by Mercury, and you're going to have a catastrophe failure of your LNG terminal, which means you're going to have millions and millions of dollars in repair cost. So they just don't want it. And so, what's happened is the industry has become more and more sensitive to it. And it's a timing matter. We happen to in the right place at the right time.

I think the best evidence of that really is we went down to Australia, and I have said this before in other calls, we went down to Australia expecting to have about GBP600,000 order, about a $1 million order. We're going to be delivering – approaching $5 million worth of product down there this year, and we think there will be $15 million to $20 million maybe $30 million over the next two years, and almost all of that is mercury detection and moisture detection. So they have seen that there is a new way to detect these trace elements and it's very effective, and they like that.

James Liberman: Thank you. And I wondered if you could give us some color also to the upcoming Italian order for the – if you're looking to deliver approximately 600 units, say, by June of next year, would you be able to do that? Would you be able to meet that kind of demand? And how would you expect that flow in terms of your production deliveries?

William Clough: Sure. Let me tell you something and if you don't appreciate this, I want everybody to appreciate this. The worst mistake we could make is to chase this order for almost five years now, get the order, and be unable to deliver a perfect product.

So as you might imagine, I spend most of my days in the U.K. making sure that we have an inventory of perfectly calibrated units that are going to go out and get delivered to the Italians. There is no doubt in my mind that we have to put forward absolutely perfect products. This is a huge opportunity for us in the sense that it builds credibility, there is nothing worse that could happen than us to deliver the product and have 10 percent or 15 percent or 20 percent failure rate.

So, yes, we are fully prepared to deliver the product in a timely basis. We very much and they are very open about sharing their build schedule, we are absolutely ahead of that build schedule. And we can, if necessary, deliver not only perfect product but spares with that product in case there is some issue with installation or whatever there might be.

So, yes, we're quite confident that we can give them what they want and what they need. Again, that's something that we are prepared to do. That is part of this new facility, it's part of the team that we put together to work on this. We our very best engineers, our very best technicians are working on getting ready for this project. So, again, while it's not the only project we have and while it's not at the be-all and end-all, it's one that we are putting a lot of effort into, there's no doubt about it.

James Liberman: Thanks, again; well done.

Operator: And I'm showing no further questions. I will now turn the call back over to Bill Clough for closing remarks.

William Clough: Yes. Just in closing, again, I want to emphasize how much we appreciate your support and interest. The company is truly at an inflection point now. I think we're at a point where over the next few months and years, this is going to be a very exciting company to be involved in. Again as things move forward, we will keep you as up to date as we can. And, obviously, both Dan and I are available. And if you have questions or have things that you are concerned about, don't hesitate to contact us either by email or by phone. Again, thank you for everything and that will end the conversation. Thank you.

Operator: Thank you, ladies and gentlemen. That does conclude today's conference. You may all disconnect, and everyone, have a great day.

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