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CUI Global Q2 2016 Earnings Call
August 8, 2016

C: Sanjay Hurry; CUI Global; IR
C: William Clough; CUI Global; President, CEO
C: Daniel Ford; CUI Global; CFO

P: Eric Stine; Craig-Hallum; Analyst
P: Joe Maxa; Dougherty & Company; Analyst
P: Rob Brown; Lake Street Capital Markets; Analyst
P: Amit Dayal; Rodman & Renshaw; Analyst
P: Marco Rodriguez; Stonegate Capital Markets; Analyst
P: Jim Kennedy; Marathon Capital Management; Analyst
P: Donald Besser; Manchester Management; Analyst
P: Gregg Hillman; First Wilshire Securities; Analyst

Presentation

Operator^ Good day, ladies and gentlemen, and Welcome to the CUI Global Second Quarter 2016 Results Conference Call.

(Operator Instructions)

As a reminder, today's conference call is being recorded. I would now like to turn the conference over to Sanjay Hurry, Investor Relations. Please go ahead, sir.

Sanjay Hurry^ Thank you, Candace. Good afternoon and welcome to CUI Global's second quarter 2016 results conference call. A copy of the Company's earnings press release and an accompanying PowerPoint presentation to this call are available for download at the Investor Relations section of the CUI Global website.

With us on the call today are William Clough, President and 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 second quarter and year to date, as well as to provide you with some additional color on the business going forward. Following management's remarks, the call will be opened up for questions-and-answers. A telephonic replay of this call will be available until August 22. 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 27-A of the Securities Act of 1933, as amended, and Section 21-E 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; our reliance on third-party manufacturers and suppliers, government agency budgetary and political constraints, new or increased competition, changes in market demand and the performance or liability of our products. These factors and others could cause operating results to vary significantly from those in prior periods and those projected in forward-looking statements.

Additional information with respect to these and other factors, which could materially affect the Company and its operations, are included in certain forms the Company has filed with the Securities and Exchange Commission.

Before starting the call, be advised that Bill will be in New York City during the week of August 15, and is available to meet with investors. Management's next conference presentation will be on September 28 in Minneapolis at the Dougherty & Company Institutional Investor Conference, where he will be available for one-on-one. Please contact me via contact details listed in today's press release or your Dougherty sales person to schedule a meeting with management.

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

William Clough^ Thank you, Sanjay. Thank you all for joining us on our second quarter 2016 results conference call. I'll start with a brief overview of our performance for the quarter, after which Dan will review our financial results in greater detail. When Dan has concluded with his remarks, I will provide some additional commentary on some of the key initiatives we are currently working on at CUI Global, including some significant milestones for both the energy and electromechanical segments of our business. We'll then open the call up for Q&A. Let's begin.

Let me start by saying I am pleased with our performance for the second quarter. This was our first full quarter of generating revenue under the Italian contract with Snam Rete Gas for our GasPT analyzer. I am very proud to say that we have delivered more than 250 devices on-time and at quantity.

As most of you know, Snam Rete was the first major gas transmission company to recognize the value proposition of our disruptive gas metering solution, and will be a great reference account for our new business development efforts. The halo effect of their acceptance of our technology has helped us successfully bring the technology before operators in Spain, Portugal and most significantly, France in the quarter, and it's helped drive the energy backlog, which sits at $15.7 million.

Concurrently, we continued to manage our power and electromechanical business through the ongoing weakness in the electronics industry, with backlog to that segment at $18.3 million at quarter-end. In total, for the second quarter we're reporting revenues up 12% sequentially to $23.1 million, as compared to $20.7 million in the first quarter of 2016 and $23 million in the second quarter of 2015. In addition to the 12% sequential increase in revenues in the second quarter, our gross profit margins remained steady at approximately 36%.

Our SG&A increased slightly as a percentage of revenues in relation to severance costs incurred of $500,000 and $800,000 during the three and six months ended June 30, 2016. These one-time severance costs were incurred as the Company transitioned the power and electromechanical R&D team to CUI Canada in an effort to capitalize on R&D efficiencies and the talent at CUI Canada as well as various other positions in both the power and electromechanical and energy segments, where headcount reductions were identified. We expect these steps will allow CUI Global to continue to improve the overall cost structure of the organization and drive results going forward.

Significantly for the six months ended June 30, the Company used only $455,000 of cash in operating activities, a dramatic reduction of $6.5 million from the approximately $7 million used in operating activities during the first six months of 2015, giving cash on hand at the end of the quarter of approximately $6 million.

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

Daniel Ford^ Thank you Bill, and good afternoon everyone. Let me take you through the financials for both the quarter and year-to-date ended June 30, 2016. As Bill mentioned, we are reporting total revenues of $23.1 million in the second quarter of 2016, as compared to $22.9 million in the second quarter of 2015. This puts us firmly within the range of analyst consensus estimates for the quarter.

A revenue increase in the energy segment of $1.4 million has offset the $1.1 million decline in our power and electromechanical segment. For the second quarter of 2016, power segment revenue was $15.4 million, as compared to $16.5 million in the second quarter of 2015. This decline is attributed to the timing of customer delivery schedules and sell-through at distribution channels.

Revenue from the energy segment in the second quarter of 2016 was $7.7 million, as compared to $6.3 million in the second quarter of 2015. Year-to-date revenues were $43.8 million, as compared to $39.5 million for the same period last year.

Revenue breakout by business segment was $28.5 million for the power segment for the six months ended, as compared to $27 million for the six months ended 2015. For the energy segment, revenue was $15.4 million for the six months ended 2016, as compared to $12.5 million for the prior-year period.

The revenues for the three and six months ended June 30, 2016 are attributable to the continued sales and marketing efforts, sales through the distribution channel customers, the addition in March 2015 of CUI Canada related products, the revenues generated since the January 2015 opening of Orbital Gas Systems North America, and the overall improved sales of gas-related metering, monitoring and control systems, including the GasPT.

The cost of revenues for the three months ended June 30, 2016 was $14 million, as compared to $14.6 million in the same period last year. As a percentage of revenue, the cost of revenues decreased to 60% in the second quarter of 2016 from 64% during the prior-year comparative period. As a reminder, this percentage will vary based upon the power and electromechanical product mix sold, the mix of natural gas systems sold, contract labor necessary to complete cash-related projects, the competitive markets in which the Company competes in a foreign exchange rate.

The cost of revenue for the six months ended June 30, 2016 was $26.6 million, as compared to $25 million in the same period last year. As a percentage of revenue, the cost of revenues decreased 61% from 63% during the prior-year comparative period. This improvement was due to the previously mentioned factors, especially the sales of higher-margin products to the energy segment. As a result of the improved product mix and energy segment, for the six months ended June 30, 2016, the cost of revenues in that segment as a percentage of revenue dropped approximately 10 percentage points from 65% to 54%. This improvement helped to offset lower margins incurred in the power and electromechanical, as the segment's cost of revenues as a percentage of revenue increased slightly to 64% from 63%.

Gross profit was $9.2 million or 40% for the quarter ended June 30, 2016, as compared to $8.3 million or 36% in the same period of 2015. For the six months ended June 30, 2016, gross profit was $17.2 million or 39%, as compared to $14.5 million or 37% in 2015. During the three and six months ended June 30, 2016, the power and electromechanical segment generated gross margins of 36% in both periods, while the energy segment generated gross profit margins of 48% and 46%, respectively.

For the three and six months ended June 30, 2016, selling, general and administrative expenses increased $1.1 million and $1.7 million, respectively, as compared to the prior-year comparative periods. This increase is largely due to $0.5 million and $0.8 million in severance costs incurred during the three and six months ended June 30. This severance was related to the transition within the power and electromechanical segment of the R&D team to CUI Canada and for various positions within the energy segment.

We expect the related changes will improve our results in go-forward periods as cost efficiencies are achieved. SG&A was further impacted by increased audit and accounting fees of $0.2 million and $0.6 million included in the other category that occurred in the three and six months ended June 30, 2016, respectively.

Partially offsetting the increased SG&A for the six-month period was $0.7 million decrease in non-severance related SG&A associated with the activities of Orbital Gas Systems North America, which had opened in January 2015, and had increased startup costs during its first two months of operation. The remaining SG&A during the three and six months ended June 30, 2016 are associated with the ongoing activities to support existing and reach new customers, promote our product lines including Novum, GasPT, IRIS, the VE-Probe technology, and other product introductions.

The Company reported a net loss of $1.5 million or $0.07 per share for the quarter ended June 30, 2016, compared with a net loss of $504,000 or $0.02 per share in the prior year period. For the six months ended June 30, 2016, the Company reported a net loss of $4.1 million or $0.20 per share, as compared to the loss of $4.6 million or $0.22 per share in the prior year period. Included in the net loss for the quarter and six-month period are the severance expenses discussed previously, without which the Company's net loss and EPS would have been within the range of analyst consensus estimates for the quarter.

Earnings before interest, taxes, depreciation and amortization, or EBITDA, loss for the second quarter of 2016 was $502,000, versus EBITDA of $179,000 for the second quarter of 2015. Adjusted EBITDA for the second quarter of 2016 was $130,000 versus adjusted EBITDA of $470,000 for the second quarter of 2015. Year-to-date adjusted EBITDA loss was $1.2 million, as compared to an adjusted EBITDA loss of $2.1 million for the six months ended 2015.

Adjusted net income or loss, which represents net income or loss plus the amortization expense of 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 second quarter of 2016, was a loss of $0.6 million. This compares to an adjusted net income of $0.2 million for the second quarter of 2015. The year-to-date adjusted net loss was $2.6 million, as compared to a year-to-date net loss in 2015 of $2.8 million.

At June 30, 2016, CUI Global held cash and cash equivalents of $6 million, a decrease of $1.2 million since December 31, 2015. Operating requirements generated a negative cash flow from operations of $455,000 during the first six months of 2016, which was a $6.5 million improvement from the negative cash flow from operations of $7 million to the second quarter of 2015.

For the three and six months ended June 30, 2016, there was a significant foreign currency translation adjustment in the balance sheet of $1.6 million and $2.1 million respectively, largely as a result of the decline in the British sterling following Brexit. That is a non-cash item that presents in equity and can also be seen on the statement of comprehensive income and loss.

With regards to Brexit, the long-term effects will depend on the terms negotiated between the UK and the EU, which may take years to complete. Our overall operations in the UK could be impacted by the global economic uncertainty caused by Brexit. The announcement of Brexit caused significant volatility in currency exchange rate fluctuations that resulted in the strengthening of the US Dollar against foreign currencies in which we conduct business, especially the British pound. The volatility in exchange rates is expected to continue in the short-term and the strength in the US Dollar relative to the British pound and other currencies may adversely affect our results of operations.

During periods of a strengthening dollar, the local currency results of our international operations may translate into fewer US Dollars. We will continue to monitor the situations surrounding Brexit and will continue to work towards solutions that grow our business and seek to limit Brexit's impact on our operations within the UK and internationally.

This concludes my prepared remarks, and I would now like to turn the call back over to Bill.

William Clough^ Thank you, Dan. Entering the second half of the year we remain focused on executing on our gross strategy to leverage our cash generating in power and electromechanical business to fund substantial growth opportunities for our energy segment.

With regard to the power segment, we continue to solidify our leadership position in the electronics market and work to gain greater market share. Subsequent to the close of the quarter, we expanded our partnership with Virtual Power Systems. In effect, our power segment has been elevated from a supplier to VPS to now being their key hardware design partner for their energy management and control solution, transforming how data centers provision, manage and utilize power capacity. With this expanded partnership, we are enabling VPS's penetration of the data center space.

Turning to our energy segment, the business driving our growth, we are employing a multi-pronged strategy to build greater industry awareness and further industry adoption. In addition to the successful Snam Rete deliveries, we reached several more significant milestones.

We announced the successful delivery and commissioning of our new GasPTi LNG analyzers to the most strategically significant and largest LNG importation terminal in Europe. We entered into a distribution agreement with Autochim for French and African sales of the GasPT and VE Technology solution, thus forming a partnership with one of the largest and most respected gas integration integrators in Western Europe.

As a division of VINCI Energies, Autochim is a company which has more than 185,000 employees across 51 countries, with fiscal year 2015 revenues of more than EUR38 billion, or $42 billion. More importantly, just like our Italian distributor, Socrates, Autochim gives us immediate credibility in the large, French natural gas market.

We announced the award of a $3 million United Kingdom network innovation competition contract for delivery of gas, quality and metering stations within the UK.

This project, funded by the UK regulator Ofcom, sponsored by the respected UK pipeline operator SGN, and supervised by the internationally recognized energy consulting group BNBGL is designed to prove the value and viability of deploying fast, accurate, relatively inexpensive monitoring sites throughout the SGN network.

We successfully beat out several major industry competitors to design, build and deliver the first 10 kiosks, including our proprietary GasPT analyzers. We installed and evaluated with the results being used by Ofgem and DNVGL to recommend deployment of such kiosks throughout Western Europe.

And finally, while not producing any immediate revenues, we also announced that Orbital Gas Systems North America became a full member of the American Biogas Council. As such, we can credibly present in North America our industry-leading biogas-to-grid metering solution which we have developed and installed throughout the UK.

We believe that the opportunity for biogas in North America is far more extensive than in the UK or Western Europe and having fully designed, installed and operated solutions based on our SGN and GasPT technologies makes us leaders in this developing North American opportunity.

Additionally in Western Europe, we are replicating the sales process used to win the business at Snam Rete. Our new distribution agreement with Autochim gives us entry into NG; the national gas transmission company in France and to certain natural gas producers in Africa. With Snam Rete as a reference customer, we believe the sales cycles will be significantly shorter. We are in active discussions with distributors that have relationships with gas transmission companies in other Western European countries, including Spain, Germany and Portugal.

Staying with Western Europe and specifically the UK for a moment, I want to address investors' inquiries received after the Brexit vote concerning the impact on our UK business operations and our ability to conduct business across the EU, given that our energy segment, Orbital is headquartered in the UK.

Brexit is expected to have a minimal effect on our business. Certifications obtained for our GasPT and GasPTi solutions in advance of our Snam Rete contract remain applicable to both the EU and UK markets. As Dan detailed in his prepared remarks, the volatility in exchange rates expected to continue in the short term, coupled with the strengthening of the US Dollar relative to the British pound, our results of operations in the UK may be adversely affected. We will continue to monitor this situation and actively pursue solutions to continue to drive performance within our UK operation.

In summary, we are executing across multiple fronts to broaden awareness of our gas solutions with game-changing technology and supported by a growing list of top-tier customers and a management team singularly dedicated to this substantial opportunity.

We have a model that we are replicating both in Europe and in North America that lays the foundation for CUI Global's long-term growth. The difference now is that our technology is not only gaining traction, that traction is reflected in our sales, deliveries and revenue.

(Inaudible) Snam Rete contract in February has allowed us to greatly eclipse the number of units we delivered in all of 2014 and 2015 combined. That project, which translates into a minimum of 3,300 units, and depending on the results, maybe as many as 7,000 units, has allowed us to deliver 263 units through the second quarter. That compares to a total of only 65 units delivered in all of 2014 and 2015.

In the near-term, we have a meeting scheduled with Snam Rete in early September, during which we expect to gain greater visibility into order flow for the balance of the year and greater clarity on our expected second purchase order under our 3,300 unit GasPTi contract.

As we look ahead to the second-half of 2016, I want to reiterate our optimism and commitment to providing superior technology, products and service to our customers. Our energy division continues to grow and the natural gas industry is increasingly beginning to recognize and adopt our leading-edge technology and devices.

The employees at CUI Global have shown tremendous tenacity in pursuing new business to grow the Company and extend our market penetration. We will continue to introduce new products, attack new markets, seize opportunities, and pursue and partner with some of the largest, most recognized industry leaders in both the natural gas and electronics markets, all in conjunction with our efforts to strategically grow our revenues, our profit, and enhance our shareholder value.

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

Q &A Session

Operator^ (Operator Instructions) Eric Stine of Craig-Hallum.

Eric Stine^ I just wanted to start with Snam Rete, maybe just talk about how the installations have gone and also how early operations have gone. I know that you've been targeting data collection from that, that you can then take to other customers. I'm just wondering where that process stands?

William Clough^ Yes, I'll know more about that in early September. I can tell you that the first units that have been installed have worked perfectly. They did have a translation issue with a flow computer, not our issue at all but flow computers issue, and we resolved that problem for them. So, we've been quite helpful for them as well. But as far as installations themselves are concerned again, I'll know more of that in September. I know that they have had scheduling issues where their tier-one contractor has been unable to gain access to certain sites at the time that they thought they would. So again, it's something that I'll know more about when we get to meet with them in early September. But I can tell you definitively that the devices have been operating flawlessly.

Eric Stine^ I know that - I mean this the initial – using the initial volumes, so it's a bit of a moving target, but I mean when you think about it, do you think that you're going to need, is it three to six months of data that you can then take to other customers? I mean, how should we think about that going forward, whether it's Snam Rete or someone else?

William Clough^ Yes, I'm pushing as hard as I can to get that data as soon as possible, but again, I'll know more in early September. I don't have it yet, but I am pushing for it. Believe me, that's something I really want, because I think it'll be a big selling point for our (inaudible).

Eric Stine^ Thinking about other customers of GasPTi, I know to this point you've thought that whether it's France, Germany, Spain, that it would be the full system. Is that still the view or is it potentially the analyzer only?

William Clough^ No. In the case of everyone other than the Italian, it's all high-pressure transmission pipelines, so they would need the GasPTi, the full solution. It's quite an oddity not only in Western Europe but really worldwide for a transmission company like Snam Rete to actually deliver low-pressure gas but that's what they do and they've been successful at it (inaudible) but they're the only ones (inaudible) that we know of who does that. So, the rest would be the whole GasPTi.

Eric Stine^ Maybe just an update on – I know you've been targeting certification in Canada. I know that you'd re-engage with TransCanada a little bit once you secured Snam Rete and you could look elsewhere. Update there? I know that you were hoping that the EU certification might carry some weight.

William Clough^ It will; they have obtained the information from the EU regulators and we have accepted that information. They actually might test obviously one of our devices themselves, which is fine. I'm being told by my technical people that we should have something sometime in September, so I think in this quarter. It sounds like their testing process is a week to 10 days, it's not a long process. But they have accepted the information from the regulators of Europe.

Operator^ Joe Maxa of Dougherty & Company.

Joe Maxa^ Thinking on the timing of the shipments of the GasPT to Snam Rete, are you expecting the orders or the flow to continue or is there potential for there to be a gap before the next quarter and when you complete the original order for 400?

William Clough^ Yes. Obviously we have the entire 3,300 units and we have [the potential] 400 committed and we're working our way through those now. We will finish with those – I believe our last shipment will be in October. I just don't know what the next series will be.

I know that they're eager to get it done. I'm certainly expecting to know much more after I meet with them face-to-face in early September, but I can't give you any timing at this point, because again and I think somebody else mentioned it, Eric mentioned it, it is the initial rollout. I know that they have had issues with scheduling, because many of these units are going into third-party facilities, even though they're paying for the installation, they have to arrange with the third parties to allow them to get in. I know that has been an issue with some sites, just pure scheduling.

So again, I'll know more at the end – maybe, the first part of September. But we expect surely to deliver these 400 flawlessly and we'll move on after that. Their project is fully funded and they expect to purchase 3,300 total units at a minimum, so we think that we'll see that second purchase order certainly in the second-half of the year.

Joe Maxa^ So, it sounds like you're still shipping 50 a month, today and with the anticipation of still getting up to a 100 by sort of next year, if that all goes well?

William Clough^ Correct. Their broad schedule is to install 800 units this year and to install 1,200 units in 2017 and another 1,200 in 2018. Then whatever is left would be in 2019. So, that ramps up to 100 units a month (inaudible), and I would expect that to happen.

Joe Maxa^ Then just looking at your backlog, being down a bit sequentially, it does make it – just thinking about where revenue could be for next quarter, it doesn't look like you have tremendous upside from maybe last year's 3Q, is that what we should be, how we should be looking at it?

William Clough^ Yes. Again, we don't – obviously we don't give forecasting, but I mean I have to point out that the industry as a whole is seeing less of a turnaround than it expects, and it's one of our largest competitors reporting more than a 40% year-over-year reduction in business, and I think in their call as a matter of fact, they talked about the fact that they had predicted that the turnaround in gas and oil would be felt sometime in April of this year. And now they've moved that out to the second quarter of next year, 2017.

We haven't seen that kind of decline and certainly, the fact that we have this Snam Rete order for us is a major utilization for that kind of problem. But again, it's a difficult market and especially just difficult in North America now because some of the controversies surrounding the presidential election. There's people holding on to their money could be waiting to see who's going to be running the country at the end of the year. So I think yes, I think your assessment would be correct.

Daniel Ford^ The other thing I'll add to that Joe, if the FX rate for the UK had stayed where they were at December 31, our backlog would have been $1.5 million higher, or even at March 31, it would have been a little over $1 million higher for the backlog. So that, the Brexit and the impact on currencies has definitely had an impact from a backlog standpoint.

Joe Maxa^ Are you having any – seeing any with the [IRIS P Element] we've been waiting on for a while now with National Grid?

William Clough^ No, it's still moving forward and I expect a decision out of them any day. They're very keen to the project, they're very keen to try our technology [and I think that’s going to be coming up].

One of the things we're partnering with GE on that very project is GE has developed a new platform that they want to introduce into the mix, which we think is quite exciting and frankly, we’ll make it a more dynamic [solution]. So, that's part of the reason there's delays, because we're presenting that new platform to them, but I think at the end of the day, we will get that PO.

Operator^ Rob Brown of Lake Street Capital Markets.

Rob Brown^ Just following up with the North American market, you talked about some delays there, but could you just update us on kind of the opportunity set and when and how you think that's going to develop, I guess (inaudible).

William Clough^ There's two segments that we think are quite exciting in North America. The first is the VE technology. That is developing at a, frankly, quite a great clip. We have now just finished the delivery and you’re now seeing installation of the second-half of our order in that south Texas ethylene plant. We expect to get – or start getting data out of those [probes] sometime in the next 30 to 60 days. And as I mentioned on other calls, that customer has [already sent forth] additional plants, more than $100 million worth of work for us, if that performs the way we think it will.

We've also had some very great interest in our biomethane-to-grid terminals. That's kind of a developing market [non-US]. But since we have so much experience [to this day], we think we could make a real impact on the market. We’ve had inquires from California to New York, and all the way in-between for our biomethane solution. So again, we think that's going to be a big operation as well.

TransCanada, as I mentioned before, has re-engaged. Once we get the measurement from Canada certification (inaudible) they want to roll out devices; I can't really say how many at this point, but TransCanada is a very big operator that has some real consistency issues coming out to our field, so it’s going to be a big opportunity for us. We expect to re-engage with Energy Transfer Partners any day now. They have finished the Williams deal as everybody probably knows, and they're definitely back interested in operational matters, and we're one of those operational matters. And they’ve had the device for it now going on two years to perform flawlessly for them (inaudible).

So then overall, the US markets and North America market is one that is just in the beginning stages still, but will rapidly I think escalate to a point where it eclipses certainly Western Europe. It's the opportunity here is tremendous because there is just so much more pipeline and so many more monitoring sites. So, we're excited about the opportunities.

Rob Brown^ Then on your SG&A costs, I noticed you did some one-time items, but what's sort of the correct run rate in that business? Is it netting out the one-time items or should they continue to decline a little bit?

Daniel Ford^ Netting out the one-time items gets you right in-line with that Q4 run rate that I had reiterated following last quarter. So the Q4 run rate should be the rate I believe.

Operator^ Amit Dayal of Rodman.

Amit Dayal^ In regards to your guidance, I didn't hear the guidance; are you maintaining it at the $105 million to $108 million levels for 2016?

William Clough^ No, we don't give guidance, Amit. I think what you’re looking for is the sense that (inaudible). I would reiterate what I said earlier, the fact that we’re seeing (inaudible) of our competitors reducing their estimates by 40% and 50%, we don't give (inaudible) estimates, so I'm not (inaudible).

Operator^ Marco Rodriguez of Stonegate Capital Markets.

Marco Rodriguez^ Hey, I was wondering if maybe you could just a little bit more about Brexit. I heard your prepared remarks and how you guys are kind of thinking through it. But just wondering, have you had an actual conversation directly with Snam Rete post the Brexit announcement?

William Clough^ Yes. Snam Rete will be affected, because they are buying in pounds, so there was no translation issue with them. The bottom line is they are in pounds. So the issue will become pertinent really with the new customers who will price at euros.

Interestingly, we pushed Snam to purchase in pounds because we felt that the euro was too volatile. Well it turns out, who knows, we might have been better staying in euro, but at this point they are in pounds. So for them, it's not an issue one way or the other.

There's no issue as far as certification, and realize that they were required to get a waiver through the EU regulatory agency to do a single-sourced, because we were the only technology that could do what they needed. So there is no Italian product, there's no French product, there's no German product that could do what they want. So it's not a matter of them no longer dealing with a British company because of Brexit; we’re their only source. There is no other technology that addresses what they need and has passed their test. So again, I think for us and Snam Rete, in terms of Snam Rete, we'll have somewhat no impact.

In the case of other future business, the certification issue is already resolved. We have certification in both EU and the UK. We had to get that because UK has always required separate certification, which we got, and then we got EU certification in conjunction with Snam Rete, so we're fine there.

What we will find though at the end of the day, if the pound stays depressed versus the euro, is that in essence we'll have a little larger margin because our cost of goods will be a little bit less. But again, it's hard for anybody to say what the end-impact will be. We know now that it will be two, possibly three years, before they resolve all the issues. I don't believe anybody is talking about heavyweight (inaudible) on either side.

They're both big customers of each other and I think they'll probably come up with a solution. In fact, I can tell you that in spending as much time as I do over there, the consensus over there is that it will turn in essence EU into basically a free-trade zone, which is what it was fully intended to be in the first place, rather than kind of a super-government, and at least vis-à-vis the British, it will become much more of a free-trade zone.

Now, how that impacts immigration and some of the other tough issues that they got to deal with, I can't tell you. But I think at least short-term, you're seeing the impact. The impact is a reduction in the value of the pound versus the US Dollar. And to some extent it's EU. [That's, as I said, like I said, no impact on us, we understand], but it will have some impact in the future.

Marco Rodriguez^ Got you. Your thought here in terms of how Brexit, obviously no one really knows what's going to necessary happen in the future, but if I'm hearing you currently and understanding some of what you're saying there, that no matter what happens from the renegotiations of all the trade aspects between the UK and all the other European countries, because you have that sort of certification there, you're thinking that it shouldn't be an issue to make a sale?

William Clough^ Correct. That's exactly right. And again, that, and the fact that we're the only viable technology that will do it.

Marco Rodriguez^ Understood, and then last question, I'll jump back in the queue. Any sort of an update you have on CUI Canada? I know that they've been a little bit of a drag on results in the power and electric. Just kind of give us an update as far as where that is in terms of your expectations and how you might be thinking about that as far as its impact on operating margins for the power and electric section.

William Clough^ Dan, you want to take that?

Daniel Ford^ Absolutely. Yes, that's still in turnaround mode. It's still having great progress with the customer base that it brought with us and the one that we're adding. We're seeing a lot of manufacturing design going in there. So, the future, the funnel is looking really good. Again, we expect that probably in year three where that will turn into the production volumes, which is really the key to having the Canadian operation turn more profitable for the (inaudible).

The other aspect to reiterate on that is the value that they brought from an R&D standpoint and a prototyping standpoint company. That was the big reason why we transitioned our R&D group up to Canada, both from the resources they had and the marketplace available through talent in the Toronto area and the power space is very, very good. That's also where we're basing our Ice Block research development program, which is based partially on a preexisting CUI Canada product. We're pleased with it. It's still in turnaround mode but it's going the right direction for us.

Operator^ Jim Kennedy of CUI Capital Management.

Jim Kennedy^ If you have not bid on or priced potential contracts outside of Italy yet, why would you not have some pricing power, therefore overcoming any pound issues or whatever going forward? Wouldn't it actually be a benefit to you given that you were sole source in one situation and you might be in others?

William Clough^ Yes, obviously that's one of the reasons we kept the pricing design so close to our vest. You're absolutely right. We do have, we believe, some real leverage there. That's the other reason I'm pushing so hard to get the data out of Italy once they have it, because again that's more leverage for us.

You're absolutely right. And if I can get two or three of these big customers on the books, so our leverage goes up even more because then I could say to them even though (inaudible) it's first come, first serve. (inaudible) and those are things that I definitely (inaudible) because they're in fact (inaudible) customers are going to have to understand. So yes, you're right, there will be definitely be some leverage.

Jim Kennedy^ Yes, at the end of the day you have a unique product, addressing large markets and patent it, so you should have the requisite pricing power.

Daniel Ford^ The other piece to add to that too Jim, and it's the obvious point, but our cost of production has gone down with that. So the customer at the end of the day can still get a better margin than they would have gotten originally, and we can still make a better margin than we would have originally. So, we are seeing this as somewhat of a marketing opportunity because of the pricing power (inaudible).

Jim Kennedy^ Sure, absolutely. Bill, any comments on the installation at your northeast customer, or mid-Atlantic northeast customer, and any feedback in terms of how that's gone, what the data looks like, what they've said about it?

William Clough^ I think if you're talking about the process of (inaudible) for the east coast (inaudible). Yes, they're certainly very excited about the results. The results have been quite good. They are acting as market resources for us and they will in fact (inaudible) to-market, and they are still very hesitant to have a (inaudible). But they have had great (inaudible).

So it's one or two or three at a time, but again, they are definitely rolling them out and they're definitely very pleased with what they see.

Jim Kennedy^ Is there any reason why in the long run you would not be an option for the compressor guys, in terms of either OEM-ing or being an option, therefore comes directly from the compressor manufacturer?

William Clough^ Yes, we’re still working through that. We are still in the process of getting to some of the big compressor manufactures, there are a number of them, Caterpillar and others that we're trying to get to. We think that's a (inaudible)

Again, not to belabor the point, there is some issues just economically at this point with that industry as a whole, because they’re seeing there’s a big downturn that others are seeing, and so because of that, they're not necessarily focused on new technology. They’re focused on getting product out the door. But again, we are working (inaudible). We have a sales team based out of Houston that are pushing really hard to get to those OEMs.

Operator^ Donald Besser of Manchester Management.

Donald Besser^ I've got three detailed questions and then one other one. Dan, what was the fourth quarter run rate for SG&A that you referred to? What was the absolute dollar number?

Daniel Ford^ It was $8.5 million.

Donald Besser^ Now when you’re talking SG&A for –

Daniel Ford^ SG&A in Q4 was $8.501 million.

Donald Besser^ For what? For the energy division?

Daniel Ford^ Sorry, I thought you said for the overall, that was for the overall SG&A. It's not been split up for the division-by-division publically.

Donald Besser^ Bill, who is the largest competitor you're referring to?

William Clough^ Yes, you know I'd rather not name them. I don't feel comfortable, I don't have any authority (inaudible) prepared call, so I don't (inaudible).

Donald Besser^ I don't see why your energy business itself is so affected by the lower price of oil and gas, maybe on prospective business, but not on your current backlog. There's no --

William Clough^ No, no. Not at all in current backlog, but I think it’s just the economic environment we're in. It's not that our business is particularly affected, in fact frankly, we we’re up. So, we haven't been negatively affected at all.

Donald Besser^ So, what's the point of complaining about a competitor to saying that your business is being hurt?

William Clough^ No, no, I'm not complaining about a competitor. What I was trying to indicate is we're in a difficult, economic time through gas and oil, just the projects and moneys are not being spent the way that the industry expects them. I'm certainly not complaining at all about a competitor. They're a competitor and they do what they do. But again what I'm saying is they identified, as we're identifying, this is a difficult economic time and because of that, there are less projects.

One of the simple facts is we're pushing very, very hard to get (inaudible) to move forward, and these are tough times to push that. It just is, because of the price of gas and because of the price of oil, because most of these big companies are involved in both sides of the energy segment, and so their infrastructures costs and infrastructure projects are things that are big dollar amounts.

Look at the Snam Rete project, that’s 160 million euro project. That's a big project (inaudible) process for almost five years and they went ahead with it, which is great for us and for everybody else.

Again, all I was pointing out is that the theme is it’s a difficult environment because of the price of gas and oil, and just because of the economic turmoil that's created by things like Brexit, things like the Clinton-Trump presidency, things that happened that are far out of our control. Certainly, I'm not complaining. We’re working through it, that's what we do, that's –

(Multiple Speakers)

Donald Besser^ Just a couple of more details. How many units has Snam Rete actually installed, do you know?

William Clough^ I don't know. I'll know more about that when I get there in September.

Donald Besser^ All right. Dan, you said that (inaudible) business in Canada was in turnaround mode. Does it have any sales?

Daniel Ford^ All the sales for the CUI Canada operators goes through CUI (inaudible) through the power segment. So, yes –

Donald Besser^ Right. So, what are the sales?

Daniel Ford^ They're included in the power and electromechanical group.

Donald Besser^ Are there any sales in the Canadian division?

Daniel Ford^ Yes, there are. That's our entire front-end power supply product line.

Donald Besser^ Okay, so we need some elaboration on that. The backlogs, since you bought that company, has declined in the power division. The sales appear to have been flat the last few quarters. What's actually going on?

Daniel Ford^ So, year-over-year the power division is up, about a little over a million dollars year-to-date for the period. Then what we're seeing is faster turnover through the organization. The other piece is when we acquired that company, it had a large upfront backlog (inaudible) both prior to our acquisition and then immediately upon acquisition customers who were afraid that they would lose their supply because they thought Tectrol was going out of business.

So, what we worked through and what we're continuing to work through is a backlog scheduling with the customers. We've seen that most of them have gotten through there overly built-up supply now and that they are reordering products from us, on a more regular basis rather than (inaudible) they had done.

Donald Besser^ All right. So, you've owned the Company for 15 months, so what is the current quarterly run rate for that division?

Daniel Ford^ The run rate for that division, the power segment did -- let's see, what are the power segment revenue, which includes Tectrol --

(Multiple Speakers)

Donald Besser^ I want to know what Tectrol did.

(Multiple Speakers)

Donald Besser^ Tectrol sat $8 million -- just a minute. Tectrol sat $8 million of cash from the Company. I want to know, you've spent all that money on -- and it was actually more than that, including working capital. I want to know what the sales rate is for that investment, that's a reasonable question. It's not like you don't break things down, that's an extremely reasonable question.

Daniel Ford^ So Don, last year that segment did, I believe it was between from Canada did between $10 million and $12 million. I believe it's the range (inaudible) that segment, in terms of CUI Canada and Tectrol. This year, we're looking at a similar run rate for the year.

Donald Besser^ Even though they worked through the backlog of panic orders?

Daniel Ford^ Yes, because what we're seeing is reordering on a more consistent basis.

Donald Besser^ So, it's basically even. So $3 million would be a reasonable (inaudible).

Daniel Ford^ That'd be a reasonable number.

Donald Besser^ Okay, all right.

Daniel Ford^ What we're working on is getting design wins, so that the next round of production with the customer when they're designed, both the existing ones we had and future products. That's where the opportunity is (inaudible) in turning around that business. That business was doing around $100 million about 10 years ago, and $40 million around five years ago now. So, it's got a lot of opportunity there with its existing base (inaudible).

Donald Besser^ And so what is your R&D expenditure here?

Daniel Ford^ The majority of our R&D in the power segment is focused on the front-end powered and the digital power market. So that for the quarter, our R&D in that space was $475,000.

Donald Besser^ Which would be mostly in Canada.

Daniel Ford^ Correct. We moved the R&D development up to Canada, so that's correct.

Donald Besser^ Okay, so I appreciate your patience. I think you want to do a little self-thinking about disclosing more about that division, since it was such a drain last year and is not contributing anything of significance, and the power division is what's been disappointing the stock market. That's what disappoints. So, you sort of got to come clean with what's going on there and what you hope to do about it.

William Clough^ Well first of all, Don, we come clean with everything, believe me. We're heavily regulated so we're very clean. Secondly, the only reason we've got the VPS opportunity in front of us, which is a huge opportunity if you know anything about the power market is because we have the CUI Canada operation, both the front-end power and the R&D.

We believe that over the course of the next several years, Canada will be a tremendous contributor to both top and bottom-line revenue and earnings. Again though, it's going to take, we talked about it when we acquired it. It was going to take up to four years to get that done. That's what we're in the process of doing.

Operator^ Gregg Hillman of First Wilshire Securities.

Gregg Hillman^ Hey, you talked about the Virtual Power Systems the deal with them. I was just wondering, for back-up, the thing that was in the news yesterday about Delta Airlines going down. I guess they didn't have a good backup power system. Do you have the capability to replace the existing vendor at Delta, or is that above your capability?

William Clough^ No, no. That's exactly the kind of thing the VPS software system addresses, the hardware system addresses. What it does is it leverages power, basically it's a combination of a battery array and very precise, very controlled power delivery. So that when a system gets [infused] load, whether it be a Delta Airline system or a Google server problem, (inaudible) huge power load (inaudible).

What happens is we can service the system, but we’ve got a temporary basis with the batteries, so that we could then draw power down (inaudible) draw power down from the grid. That's exactly what it does.

The issue though is, as is anything that gets done in the electronics (inaudible), anything that gets done at the Blade server level, there's data testing that has to go on (inaudible) do not put power supply systems on those big server (inaudible) and that's what were in the process of doing.

We've got some really significant design wins, we've got some big partners who are looking at it, and frankly, that's why we think it's such a big deal. It's not just Delta. It's Delta, it's Southwest, it's Google, it's anyone who uses these big server farms to keep track of data and have a power (inaudible). That's what happens. Now I'm not particularly intimately involved with what happened at Delta, but if it was a power problem, that's exactly what VPS is designed to address.

Gregg Hillman^ And I take it with VPS, is that a VAR-serving or (inaudible) in Canada, or do they serve the whole world?

William Clough^ I didn't catch what you're asking, what is it?

Gregg Hillman^ The one, that joint venture the Virtual Power Systems, does that serve just Canada or do they serve the world?

William Clough^ No, VPS is not a Canadian company, it's a California company. I'm not sure –

(Multiple Speakers)

Daniel Ford^ We have the exclusive rights with them for this technology globally. So, we're going to market with them globally.

William Clough^ I got your question, yes. No, it's global, Gregg. Yes, it's global. It's globalized.

Gregg Hillman^ Okay. And then these server farms, the backup power, I take that’s a major -- that's going to be a major part of your division going – that division going forward, the power division, I take it, backup power systems?

William Clough^ Again, depending on the rollout of this VPS technology (inaudible) VPS is the software designer, but depending on the rollout of that, it could be a very, very major part of the business, absolutely, because again, it is unique. We don't own the, or have any rights to the software, that's certainly VPS's proprietary software, but we now will be designing and building all the hardware to support that software. So, yes, it could be very big.

Gregg Hillman^ Why is your solution here better than the solution of other people out there? Or how is your solution differentiated with Virtual Power Systems software and your hardware? How is your system differentiated?

Daniel Ford^ The solution, to be clear, the solution isn't a backup battery, it's not a backup battery system. So, that's something that companies are still going to have. What our solution is, its software managing the power supply system. So what it does is in times of lower usage, what it does is it diverts or peak shaves power and stores it in the battery componentry that's part of our power supply system.

So that when there are cases of high internet volume, where their servers get a bunch of requests, the power is able to draw not only from the grid, but also from the stored backup battery so that that big draw from the internet doesn't cause a crash internally where they end up having an array go down. What that allows them to do is operate more efficiently and more responsive, with less capital outlay on an ongoing basis.

They're still going to have a backup battery and probably a generator system and all those kind of things. What we allow them to do is, let's call it peak shave and respond quicker to the power needs without crashing any of their Blades, essentially.

Gregg Hillman^ Okay. And your partner is providing more of the software solution, you're providing more of the physical design pieces that go along with the software solution, the intelligent management of the power?

Daniel Ford^ Correct.

Operator^ (Operator Instructions) That concludes our question and answer session for today. I'd like to turn the conference back over to Mr. Clough for closing remarks.

William Clough^ Thank you everybody for attending the call. Again, we will continue doing as we have in the past pushing the products forward, both in the electronics division and in the power and energy division. We are quite excited about the opportunities coming forward. I think we have some very dynamic technologies in both power and energy. We thank all of you for your support, your time, your questions, your interest. If we can [explain] any further interest, don't hesitate to call us.

Thank you and thanks to everyone else.

Operator^ Ladies and gentlemen, thank you for participating in today's conference.