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CUI Global, Inc. Q3 2016 Earnings Conference Call
November 10, 2016

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

P: Joe Maxa; Dougherty & Company; Analyst
P: Eric Stine; Craig-Hallum; Analyst
P: Rob Brown; Lake Street Capital Markets; Analyst
P: Amit Dayal; Rodman & Renshaw; Analyst
P: Jeff Bernstein; Cowen Prime Advisors; Analyst
P: Marco Rodriguez; Stonegate; Analyst
P: Gregg Hillman; First Wilshire Securities Management; Analyst
P: Alex Blanton; Clear Harbor Asset Management; Analyst
P: Andrew D'Silva; B. Riley; Analyst

+++ presentation
Operator^ Good day, ladies and gentlemen, and welcome to CUI Global's third quarter 2016 earnings conference call. As a reminder, today's conference call is being recorded.

I would now like to introduce your first speaker for today, Sanjay Hurry, you have the floor.

Sanjay Hurry^ Thank you, Andrew. Good morning and welcome to CUI Global's third 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 this morning are William Clough, President; and Chief Executive Officer; and Daniel Ford, Chief Financial Officer.

The purpose of today's call is to review the company's financial results for the third quarter and year-to-date, as well as to provide you with a look ahead to fiscal 2017. Following management's remarks, the call will be opened up for question and answers. A telephonic replay of this call will be available until November 24. You may also access the archived webcast and the 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 within the meaning of Section 27A of the Securities Act of 1933 as amended and Section 21E of the Securities and Exchange Act of 1934 as amended. Such statements are subject to risks and uncertainties that could cause actual results to vary materially from those projected in the forward-looking statements. The company may experience significant fluctuations in future operating results due to a number of economic, competitive, and other factors, including, among other things, 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 management will be in New York City on Wednesday, November 16th for the Craig-Hallum Alpha Select Conference, and Dallas the next day, the 17th, for the Southwest IDEAS Conference. Management will be available for one-on-ones at both conferences. Please contact me via contact details listed in today's earnings press release, your Craig-Hallum salesperson, or the Southwest IDEAS conference to schedule a one-on-one with management.

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

William Clough^ Thank you, Sanjay. Good morning, everyone, and thank you for joining us on our fiscal third quarter 2016 results conference call. I appreciate you joining us on this early morning call. Given the Presidential election, we thought it prudent to put some distance between that result and our results, and opted to report a few days later than we typically would. Next quarter, we will return to our usual reporting schedule.

I will start with a brief overview of our performance for the quarter; after which, Dan will review our financial results in detail. When Dan has concluded with his remarks, I'll provide you with an overview of how our progress to date positions us for strong growth in 2017. We will then open the call up for Q&A.

To start, our performance in the third quarter was driven principally by strength in our Power and Electromechanical business, and some improvement in the North American headquarters of our Energy business in Houston. In what will be a recurring theme from our remarks this morning, the steps we have taken over the past several quarters to grow market awareness and increase market adoption across both of our business segments are fueling our results today and put us on a path to greater growth in fiscal 2017.

Let's begin with an overview of the electronics business. As you are aware, the electronics industry continues to work through an oversaturation of inventory and lower manufacturing levels. There are pockets of strength in the market however, and we are seeing distributors for products do well with certain of our SKUs. In the face of a stagnant market, these pockets of demand for our product present an opportunity for us and we are taking steps to capitalize on this demand. The Power and Electromechanical backlog at quarter end stood at $18.2 million.

We continue to be very enthusiastic regarding our partnership with Virtual Power Systems, VPS. This partnership, based primarily on the manufacturing and R&D capabilities that came from our acquisitions of CUI-Canada, should be a large revenue generator for us as we bring this exciting technology to market in 2017. I will touch on this in greater detail after Dan's remarks.

Turning to our Energy business, with the announcement of our Snam Rete contract in March of this year, we demonstrated a path penetrating the market opportunity for our GasPT solutions in Western Europe. To date, we have delivered 400 units to Snam Rete, including a 100 in this quarter. These initial units have all been successfully delivered on time and on budget, which demonstrates both our capabilities and the viability of this unique technology.

Last month, we announced that Snam Rete had advised us that due to certain procedural issues outside of their controls, the next product would be scheduled for the first quarter of 2017. For its part, Snam has expressed its satisfaction with our performance to date, and it has reiterated that our 3,300-unit contract is fully funded. They also reiterated that no competing technology currently exists to displace it. While we are disappointed with the break in deliveries, our long-term opportunity with Snam is reaffirmed.

Beyond Snam Rete, we continued to build our business in Western Europe in the third quarter and expanded our scope of work with two of our most mature energy customers, National Grid and Scotia Gas Networks. Our five-year $40 million framework agreement with National Grid, in particular, speaks for our growing reputation as one of the natural gas industry's leading system integrators, and further demonstrates market recognition of our capabilities and our innovative gas solutions. Further, as I mentioned earlier, our new office in Houston performed well on a sequential basis, offering early validation of our North American strategy. New awards for our Energy business in the quarter drove segment backlog to $13.4 million.

In total, we're reporting revenues up slightly on a sequential basis to $23.3 million as compared to $23.1 million in the second quarter of 2016, and $24.9 million in the third quarter of 2015. Gross margin in the third quarter of 2016 declined slightly on a sequential basis to approximately 37%. Perhaps the most significant, we have made great strides in improving working capital. Cash flow from operations of $1.1 million is an $8.4 million improvement from $7.3 million negative cash flow in the same period in 2015. This in turn led to an increase in our cash and cash equivalents to more than $7 million as of September 30.

I'll now turn the call over to Dan Ford, our CFO, to review our financial results in detail. I will then conclude the call with my thoughts on the balance of the year and a look ahead to fiscal 2017. I will then open the call for Q&A. Dan?

Daniel Ford^ Thank you, Bill and good morning everyone. Let me take you through the financials for both the quarter and year-to-date ended September 30, 2016. As Bill mentioned, we are reporting total revenues of $23.3 million in the third quarter of 2016 as compared to $24.8 million in the third quarter of 2015.

For the third quarter of 2016, Power and Electromechanical segment revenue was $16.2 million, as compared to $16.6 million in the third quarter of 2015. This decline was due to the timing of customer delivery schedules and sell-through activity of distributors.

Revenue from the Energy segment in the third quarter of 2016 was $7.1 million as compared to $8.2 million in the third quarter of 2015. Revenue in the Energy segment was down $1.1 million in the three months ended September 30, 2016, due primarily to the currency translation impact to revenue following the Brexit vote in June 2016.

Year-to-date revenues were $67.1 million as compared to $64.4 million for the same period last year. Revenue breakout by business segment was $44.6 million from Power and Electromechanical for the nine months ended September 30, 2016, as compared to $43.6 million for the prior year period. And for our energy segment year-to-date revenues was $22.5 million for the nine months ended September 30, as compared to $20.7 million for the prior year period ended September 30, 2015.

Revenues for the three and nine months are attributable to continued sales and marketing efforts -- sales through the distribution channel customers; the addition in March 2015 of the CUI-Canada related product line; the revenue generated since January 2015 opening of Orbital Gas Systems, North America, and overall improved sales of gas-related metering, monitoring, and control systems, including GasPT.

The cost of revenue for the three months ended September 30, 2016, was $14.7 million as compared to $15.5 million in the same period last year. As a percentage of revenue, the cost of revenues increased to 63% in the third quarter of 2016 from 62% 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 gas-related projects, the competitive markets in which the company competes, and foreign exchange rates.

The cost of revenue for the nine months ended September 30, 2016, was $41.3 million as compared to $40.5 million in the same period last year. As a percentage of revenue, the cost of revenues decreased to 62% from 63% during the prior year's comparative period. This improvement was due to an improved product mix, including an increased volume of higher margin GasPT sales in the Energy segment.

As a result of the improved product mix in the Energy segment for the nine months ended September 30, 2016, the cost of revenues as a percentage of revenue for that segment dropped 9 percentage points from 65% to 56%. This improvement helped offset lower margins incurred in the Power and Electromechanical segment as the segment's cost of revenues as a percentage of revenue increased slightly to 64% from 62%.

Gross profit was $8.6 million or 37% for the quarter ended September 30, 2016, as compared to $9.3 million or 38% in the same period of 2015. For the nine months ended September 30, 2016, gross profit was $25.8 million or 38%, as compared to $23.8 million or 37% in the prior year period. During the three and nine months ended September 30, 2016, the Power and Electromechanical segment generated gross profit margins of 35% and 36%, respectively; while the energy segment generated gross profit margins of 40% and 44%, respectively.

For the three and nine months ended September 30, 2016, selling, general, and administrative expenses increased $0.1 million and $1.8 million, respectively, compared to the prior year comparative period. The increase for the nine-month period is largely due to $0.8 million in severance cost incurred in the Power and Electromechanical segments for the transition of the R&D team to CUI Canada and for various positions within the Energy segment.

Increased audit and accounting fees in the three and nine months ended September 30, 2016 of $0.2 million and $0.8 million, respectively, contributed to the increased SG&A in both the three- and nine-month period. Partially offsetting the increased SG&A for the nine-month period was a $0.6 million decrease in non-severance-related SG&A associated with the activities of Orbital Gas Systems, North America, which opened in January 2015 and had increased start-up related costs in its first three months of operations.

The remaining increases in SG&A during the three and nine months ended September 30, 2016, were 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. SG&A increased to 35% of total revenue compared to 32% of total revenue during the three-month period ended September 30, 2016. For the nine-month period ended September 30, 2016, the percent of SG&A increased to 39% of total revenue compared to 38% in the nine-month period ended September 30, 2015.

The company reported a net loss of $0.5 million or $0.02 per share for the quarter ended September 30, 2016, compared with a net loss of $59 thousand or $0.00 per share in the prior year period. For the nine months ended September 30, 2016, the company reported a net loss of $4.7 million or $0.22 per share as compared to a loss of $4.6 million or $0.22 per share in the prior year period. Net loss for the three and nine months ended September 30, 2016, was primarily the result of lower gross profit margins in the Power and Electromechanical segment; selling, general and administrative expenses related to Orbital Gas Systems, North America and manufacturing costs at CUI-Canada, Inc., as well as severance costs in both Power and Electromechanical and Energy segments; increased audit and accounting fees in the other category; and the ongoing amortization of intangible assets related to the Orbital Gas Systems Limited and CUI-Canada acquisitions.

Overall, the results in the nine months ended September 30, 2016, compared to the nine months ended September 30, 2015, showed improved results in the Energy segment, which were partially offset by lower margins in the Power and Electromechanical segment, and higher taxes in our foreign operations. Energy segment operations were improved despite headwinds from lower translated British pound results due to Brexit. These overall results are compared to the first nine months of 2015, which were negatively affected by the downward pressure on income in 2015 from start-up costs associated with Orbital Gas Systems, North America and CUI-Canada.

Earnings before interest, taxes, depreciation and amortization for the three and nine months ended September 30, 2016, were $0.1 million and a loss of $2.1 million, respectively. EBITDA for the three and nine months ended September 30, 2015, was $0.6 million and a loss of $2.3 million, respectively. Adjusted EBITDA for the third quarter of 2016 was $0.2 million versus adjusted EBITDA of $1 million for the third quarter of 2015. Year-to-date adjusted EBITDA loss was $0.9 million, as compared to an adjusted EBITDA loss of $1 million in the comparable prior year period.

Adjusted net income or loss, which represents net income or loss plus 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 of 2016, was a loss of $53 thousand, compared to an adjusted net income of $0.6 million for the third quarter of 2015. Year-to-date adjusted net loss was $2.7 million as compared to an adjusted net loss of $2.2 million in the comparable prior year period.

At September 30, 2016, CUI Global held cash and cash equivalents of $7.1 million, a decrease of $0.2 million since December 31, 2015. Operating requirements generated a positive cash flow from operations of $1.1 million during the nine months of 2016. This was an $8.4 million improvement from negative cash flow from operations of $7.3 million through the nine months ended 2015.

For the three and nine months ended September 30, 2016, there was a significant foreign currency translation adjustment to the balance sheet at $0.8 million and $2.9 million respectively, largely as a result of the decline in the British pound leading up to and 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, following the June 23 referendum, we have seen volatility in exchange rates, in currency exchange rate fluctuations that resulted in the strengthening of the U.S. dollars against foreign currency in which we conduct business, especially the British pound.

Volatility in exchange rates is expected to continue in the short term, and the strength in the U.S. dollar relative to 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 U.S. dollars as they did in the third quarter ended September 30, 2016. We will continue to monitor the situation surrounding the Brexit and will continue to work towards solutions that grow our business, and seek to limit Brexit's impact on our operations within the U.K. and internationally.

This concludes my prepared remarks. I will turn the call back over to Bill.

William Clough^ Thank you, Dan. With industry-shifting technology for the Energy markets, underpinned by our profitable Power and Electromechanical business, our strategy in fiscal year 2016 has been to build awareness and increase adoption of our energy solutions to drive growth.

As I noted earlier, 2016 to-date has been a stagnant year for the electronics industry. In the third quarter, however, we saw inventory levels of distributors begin to move lower demonstrating increased demand for our products. Certain of our products are doing well with favorable product mix driving Power and Electromechanical performance in the third quarter. Inventory oversupply conditions still exist within the industry, but there is no oversupply of CUI Inc. products in distribution channels. In a weak business environment, the fact that our performance has remained largely steady speaks to not only our product mix, but also how we are interacting with our customers and distributors.

We currently count three of the industry's top electronic distributors as partners. Given our product mix and our commitment to bringing leading-edge technologies to the market, we see opportunities to on-board other channel partners and major distributors globally, expanding customer reach and driving growth in this business.

Growth through innovation is also a core tenant of the Power and Electromechanical business. And to that end, we're working on some interesting technologies that can be drivers of growth in the business. In January, we established and subsequently extended our partnership with VPS, to become their hardware vendor of choice for the ICE Block technology that targets server farms to help them operate more efficiently during peak demand times. ICE Block can help them lower their cost and increase their revenue because it allows them to operate during peak demand times when others cannot. We believe this could be a very big opportunity for us and are currently in beta with several large potential customers. We believe ICE Block has the potential to be a revenue generator in late 2017.

While the Power and Electromechanical segment affords as a solid foundation of growth, our Energy segment is our growth vehicle. Having just completed only our second full quarter of generating revenues under the Italian contract, we have and continue to take steps to broaden our opportunities set. The consequence of our business building is that we believe we are on the cusp of a breakout year in 2017 when it will be driven by energy product sales. Each opportunity pursued, each partner secured, and each sales cycle entered has been in pursuit of volume sales for these products.

Let me now take a few minutes to illustrate what we have done and where we're headed with this segment. Snam Rete is a transformational opportunity for CUI Global. And that transformation continues and is already moving beyond this one customer. Snam gave our GasPT Solution instant credibility in the market for the fiscal monitoring of gas. For reasons I explored on prior earnings call, Western Europe was our immediate opportunity with GasPT, and the Italian contracts validated our decision. Our go-to-market strategy centers on partnering with highly respected in-country distributors such as Socrate in Italy and Autochim in France and largely French-speaking Africa.

Today, we have the partner network in Western Europe, with which to pursue every GasPT opportunity of size there. It is our estimation that the market opportunity in Western Europe is about 12,000 to 15,000 GasPT units. That figure does not include our 3,300-unit contract in Italy.

Let me briefly sketch out our roadmap for Western Europe. France has the most advanced energy legislation in the European Union, and they're very motivated to deploy fiscal monitoring solutions like ours as they move to add green energy, specifically bio-methane. Engie in France has become very receptive to our GasPT Solution as a consequence of our Italian contracts. Engie has accepted all of Snam Rete's testing and EU certification. It isn't questioning the durability of our units nor their accuracy or even if we can deliver units at volume. In effect, Snam Rete has shortened our sales cycle in France, and we expect that winning a contract with the French will in turn make it easier to penetrate the rest of the Western Europe.

Further along the roadmap, we see Scandinavian's motivations being on par with France with Gasunie having tested and already adapted the GasPT. We expect Scandinavia to be followed by Germany, Spain, and Portugal as we continue along the roadmap.

In North America, the primary application of the GasPT is as a process control device for big two-stroke gas fire compressors and the gas turbine power generation market. We have been laying the foundation for a relationship with one of the largest turbine manufacturers in the world and are pleased to report that we have graduated past that entity's turbine R&D team and have now engaged the decision-makers for the turbine business globally.

While we are still some ways away from a formal relationship with that customer for inclusion on their turbines bill of materials, we are seeing progress towards that goal. According to the industry statistics, the turbine power generation market currently consists of over 50,000 operating machines that are providing a significant portion of the world's electricity. And that number is growing every day as governments move away from coal, nuclear, and other forms of energy production.

Another key opportunity in North America is with a major Canadian operator. That operator would use the GasPT device to manage inconsistencies in the gas that is coming out of the tar sands in Alberta. GasPT can be used to efficiently, economically, and accurately blend the gases entering that network to achieve consistency.

Our opportunity in North America also extends beyond our GasPT Solution. Much like Snam Rete has changed our conversation with other countries in gas transmission operators; so, too, is our partnership with Daily Thermetrics changing the conversation we're having with the largest gas transportation companies in this geography.

In licensing our thermal well application, Daily Thermetrics is offering our technologies as part of their proposals to their customers, the likes of which are some of the most iconic energy producers and transporters in the world. Daily Thermetrics not only gives us entrée into operators we previously had limited access to, it also gives us opportunity to cross-sell our sampling systems, our VE-Probe, to thermal well customers. An integrated thermal well and VE-Probe solution is a replacement technology applicable through the hundreds of thousands of thermal wells throughout the North American pipeline system. We expect material revenues from this partnership in fiscal 2017.

Our sampling systems have broad applications. Anywhere you sample gas is an opportunity for sale of our VE-Probe. I previously discussed deploying our sample systems at a large scale ethylene plant operator in Texas where it is being used for trace element detection of moisture. I'm pleased to report that we have deployed the sampling system and are now awaiting performance results, which we expect to receive in the first half of 2017.

Positive results from this deployment could lead to a rollout to the operators 54 other plants. To remind you, this was an initial approximately $2 million contract. And as we demonstrated reduction in costly maintenance downtime at these plants, we expect this will create demand for other operators in the marketplace.

Our sampling systems are also very applicable to liquid natural gas terminals as a means to accurately detect trace elements such as mercury, moisture, H2S, and more in the LNG process. We have successfully deployed such trace element detectors in the Gorgon project in Australia and will continue to pursue LNG opportunities throughout Australia and the rest of the world. I think I have conveyed our belief that our opportunity set for energy product heading into fiscal 2017 is considerable.

Turning briefly to the balance of fiscal 2016, we will continue to build the business, and establish customers and partner relationships in furtherance of our goal of broadening and increasing our energy product sales and revenues. Concurrently, we will continue to leverage our gas engineering expertise in pursuit of integration contracts and pursue relevant opportunities with our Power and Electromechanical divisions all in an effort to grow our revenues, reach our goal of profitability, and enhance shareholder value.

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

+++ q-and-a
Operator^ (Operator Instructions) Our first question comes from the line of Joe Maxa with Dougherty & Company. Your line is open.

Joe Maxa^ I wanted to ask a little more on the Snam Rete Gas that pushed back to Q1, where you are expecting to receive an order in the fourth quarter with deliveries beginning early Q1 or should we think it more than later in the quarter? What's your overall thought on that and as far as the expectation of doing potentially 1,200 units next year?

William Clough^ I don't know the timing. They've told me that they are eager to get started and it is a relatively complex tariff issue, but they are dealing with it. Again, it has nothing to do with the technology, nor with the deliveries or anything at all to do with anything other than a process that they have to go through to get this tariff situation resolved. I just don't know when that's going to happen, although they've assured me that it will happen this year and they will immediately move forward once that has happened.

It is still their plan according to them to take delivery on and install 1,200 units next year. I've heard no change in that regard. And I just had technical team out there, we're presenting another technology to them and that was -- they heard exactly the same thing, and this was late last week. So, again, we are very comfortable that we are still looking at 1,200 units next year. I just don't know when those deliveries will start.

Joe Maxa^ Okay, understood. And as far as the French operator goes, what is the current expectation ahead of today's -- bring a couple into field trials yet?

William Clough^ They have two in field trials actually right now, one in an LNG terminal and one in a pipeline setting. And we're in discussion. They are quite impressed. They have been very cooperative and I think -- I feel things are moving forward much, much quicker than with the Italians, simply because it's now a much more accepted technology. So, again, I have nothing specific to report other than the negotiations have been much more eager on their side and much more productive.

Joe Maxa^ Okay. That's good. On the electronics side, it sounds like things have picked up and you're expecting to be better then you saw in the first half of the year. We have seen some seasonality in the fourth quarter, typically, are you expecting that again this quarter or do you think you have seen enough strength or you can maybe offset some of that sequentially?

Daniel Ford^ We have seen strengthening in the segment for certain -- our products are moving well through distribution again and our direct customers are all performing really well. So that's been a nice recovery from the first half of the year, really from the last quarter and the first quarter -- last quarter of last year and the first quarter of this year was really the difficult quarters, especially.

The fourth quarter is typically a light quarter just based around people do build-up production in Q2 and Q3. We do expect that to occur again. So, I would expect consistency, similar to last year to the fourth quarter.

Operator^ Thank you. Our next question comes from the line of Eric Stine from Craig-Hallum. Your line is open.

Eric Stine^ So just interested in digging in a little bit on Daily Thermetrics, I mean you're clearly positive on that and early impressions sound pretty good, you know what -- since they are selling the probe, I'm just curious how you are going to work with that company. You mentioned cross selling, but I mean do you anticipate getting point-of-sale information or how do you think that plays out and impacts your ability to also sell down the road GasPT and potentially IRIS to some of those customers?

William Clough^ Yes, good question. The relationship with Daily Thermetrics is this, we have taken, basically the lowest priced item that we sell in the VE technology, which is the thermal well, it's really kind of a commoditized item that we produced and they can run anywhere from $800 to $1,500. What we've done is, we've licensed that to them on the basis that they will allow us and actually they want us to go into the customer presentations with them. We put our engineering team in.

The thought there is, we get a revenue stream from licensing, but more importantly we have yet to have anyone who tried the thermal well, who could not move into the sampling system because it makes sense, you've got the same penetration of a pipe as you do with the thermal well, except now you're trying to actually draw gas out of the pipeline, which we're quite effective at. So, we believe this is going to be a great entree into these bigger customers. And frankly, our guys are pushing the whole product portfolio from IRIS to GasPT to everything else.

We certainly feel there's a heck of an opportunity with the VE technology. In addition, Daily Thermetrics is an internationally recognized manufacturer of these thermal wells and sampling probe. So they are becoming our North American manufacturer. While they will sell the thermal wells and give us introductions into the customers who buy those thermal wells, we will be the ones selling the sampling system, they'll be manufacturing them and we'll be making those margins ourselves. So that's the relationship.

Eric Stine^ Okay. Thanks for that color. Maybe just on the ethylene opportunity, you mentioned, well I mean it sounds like your confidence level has grown perhaps since last call, thinking that you could see some pretty substantial growth in 2017. I would think that's maybe back half loaded, but just maybe though in terms of other customers. I mean clearly big opportunity with this one customer, but with the reference -- a technology that's being used in an application and a reference site, what do you think or what are you seeing from other customers in that application?

William Clough^ Well we're focused on this one customer simply because this is the reference customer. So we're making sure that everything is good with them. And the reason I'm a little more confident is because now we have installation, the sampling systems are in and they appear to be doing exactly what we thought they would do, and that is, giving the customer very accurate measurement of moisture in the drier beds.

As I think we talked about before, they currently shut these plants down anywhere from 8 times to 11 times a year for at times several days so they can dry these dryer beds out prophylactically because they're just not sure how much more is there. They see the accuracy that they are seeing and if they're able to take that from 11 shutdowns a year to 4, which is what they are going to do once a quarter, it makes the return on investment really a matter of weeks or months, not the years, some very fast turnaround.

So once we have that, we certainly will go out to the market with that and those results. And that is, initial results are quite positive. So again, I think the ethylene production is an increasing production because it is a clean fuel, so it's not going away anytime soon. It's going to get greater and greater as green fuel demands grow. But again, we think it's going to be a big product for us and you're absolutely right, probably in the second half of 2017.

Eric Stine^ Okay. Maybe last one for me, just to clarify or get updated thoughts. When you think about these other customers, the ones that you referenced in Western Europe, do you still believe that they would be more looking for these full system rather than just the analyzer?

William Clough^ Yes. That is what we found. That's -- the French are interested in the GasPTi, that's what they're testing is the GasPTi, which is the integrated unit. The same thing in Gasunie in the Netherlands, that's what they're using now. So yes, we believe that other than it still appears evident that other than Italy, everyone else is all high-pressure, and so they would be using the GasPTi.

Operator^ Thank you. Our next question comes from the line of Rob Brown from Lake Street Capital. Your line is open.

Rob Brown^ On the North American business, you had some success there, but other than the ethylene plant, could you just give us an overview of what the opportunities are in 2017 in the North American segment?

Daniel Ford^ Yes, currently, we're doing a lot of good business with more integration style projects, building sheds for analysis, measurement and analysis. We have some opportunities in biogas that we believe could come to fruition in late 2017, things for bio-methane to grid applications or bio-methane to power generation applications. Those are coming out of more of the green areas in the industry, particularly on the West Coast.

And then the VE sampling is an area that we are seeing a lot of opportunities coming, as well as Bill mentioned previously. So, those are the main areas. But the core -- I guess the core opportunity behind that segment is the VE sampling at the chemical plants right now, and then the analysis and measurement systems that we are putting together.

Rob Brown^ Okay good, thank you. And then back to the French opportunity, what sort of your latest thoughts on the opportunities you say is there, and maybe there -- how they would roll out, would it be similar to Italy unit numbers or would they take a different path in the roll-off.

William Clough^ It's hard to say. We are in initial discussions now. I think their need is slightly less than Italy. I think their actual need, if they did what Italy is doing, which is basically address their large scale customers would be around 2,500 units. So, close to Italy, but not quite that big.

We've been in conversations with them about some really unique concepts. I mean there is even discussions going on now as to rolling these out across their residential customer list, and they would do that in a way where we would have a GasPT device connected by some type of wireless technology to smart meters that they're rolling out across their residential network.

So, it would allow the smart meters to provide the CV at an accurate basis. That would allow smart meters to tell the customer, the residential customer exactly how much gas they are using, how much energy they are using and what the cost is. If that rollout occurred, I mean it would be tremendously bigger. They are talking about fairly, not fairly, but huge numbers. So, again, it's hard for me to say at this point. The French are really motivated to get green. They're having not a lot of success with nuclear right now because of some real discrete problems since they've had with some suppliers that have supplied them with faulty parts. So, they are finding that their nuclear power is becoming less and less dependable. They don't have any interest in coal, obviously no interest in oil, but natural gas is becoming their real go to energy source, and I think they have some unique thoughts on what they want to do.

So it's hard for me to say how it will roll out, other than if it rolls out same as the Italians, it would be a little bit smaller, about 2,500 units.

Operator^ Thank you. Our next question comes from the line of Amit Dayal from Rodman & Renshaw. Your line is open.

Amit Dayal^ In regards to the next quarter, given this break from deployments at Snam Rete, how should we look at the revenue sort of coming in sequentially in next quarter and the margin as well?

William Clough^ I think, again we don't give guidance, but I think it's fairly obvious from what we've talked about that it's going to be a soft quarter for us. It is -- we see some flattening in the electronics division. And with the break in the Snam Rete, we will see some softening in the Energy division as well. So with that being said, I think it's going to be comparable, maybe a little lower than this quarter has been, right.

Amit Dayal^ All right, understood. And then in regards to any Forex related repercussions from Brexit, is this sort of a near term issue that is manageable or how should we sort of look into that aspect of the recent developments over there?

Daniel Ford^ I wish I had a crystal ball to tell you the truth. It looks like the devaluation of the pound is going to be around for a while. So, unfortunately, that's going to impact the U.S. dollars that we recognize from that business in the UK. But the business is performing well, the customers are doing well, projects are coming online over there. We've had some good announcements from our partners with National Grid and Scotia Gas. So, overall we're pleased with the business. I wish the currency was better. There is not a lot we can do with regards to that. It does help us when we're pricing in foreign currencies outside of the British pound, obviously it costs us a little bit less when converting to USD to produce the goods. So, we may be able to pick up a little bit of margin on that aspect when we are selling in euros and dollars, but that's sort of the outlook on that right now. We're watching the currency, but there's not a hedge that necessarily would make sense for us right now.

Amit Dayal^ Understood. And then, just maybe one last question. This $40 million from National Grid, should we assume this goes as part of your backlog starting next quarter?

William Clough^ The $40 million is not in there yet. But that is an already committed project and service contract that we have with them that we'll continue and you can, in essence, through that $40 million to be a minimum, that's $40 million committed. We think there's going to be a tremendous opportunity over the next few years with National Grid, simply because their RIIO initiative caused them to take a two-year break in infrastructural work. So, they have some incredible problems with infrastructure that they need to address. And they have a lot of money, quite frankly, sitting on their books to address, but we think it's going to be a very great relationship, but the $40 million is committed project and service contracts that we'll get over the five years.

Operator^ Thank you. Our next question comes from the line of Jeff Bernstein from Cowen Prime Advisors. Your line is open.

Jeff Bernstein^ Just a quick question on the Snam Rete data you guys were sort of waiting for that for a little while, can you just give us the an update. You did talk about entity accepting that data, but can you just give us some more details on what you found?

William Clough^ Yes, again, it's not really enough of a sample for us to rely too heavily on it simply because of this issue. They have not been able to broadly install units yet. What we have gotten has been very positive though. They are seeing up 15% increase in revenue capturing, which is what they were looking for, somewhere between 10% and 20%. So, 15% is right where they thought it would be. We've given those initial statistics to the French, but again I think the sampling is not broad enough yet for us to have something to publish. That's what we're waiting for and it won't be until they get this tariff situation resolved.

Operator^ Thank you. Our next question comes from the line of Marco Rodriguez from Stonegate. Your line is open.

Marco Rodriguez^ I was wondering if maybe you could provide a little bit of an update on CUI-Canada or the Tectrol acquisition, just kind of where you are now in terms of that, given that moving forward?

William Clough^ Yes, I think we are seeing now some design wins, which we expected because we now have our sales group. Most significantly though I think what we've been able to do is capture some real savings in SG&A by moving our R&D facility up to Canada and really consolidating our electronics R&D up there. In that regard, we've really been focused on the VPS product the ICE Block product. We think that there is a heck of an opportunity in that regard. We have a great relationship with VPS. As you probably are aware now, we've announced that we are their exclusive hardware provider. Actually met with their CEO in San Jose, I think a week and half ago now, and they are quite excited about what's going on in the industry.

So, we think that CUI-Canada is at the end of the day going to be quite a profitable piece of business for us. It is though still a work in progress. There is no two ways about it and I'll Dan can comment on where we think that work in progress is.

Daniel Ford^ Sure, thanks, Bill. The revenue is tracking. I mentioned last quarter that the revenues are right around $3 million a quarter, that is still tracking and that's what we were targeting for the year. The customers that we got with the account or with the purchase, they are all ongoing business, they are reordering production size orders. Key to that is that those relationships are also -- some of them have expanded into our other products, winning designs for our existing CUI product line that we had before as well. So it's expanding that business opportunity, but -- and frankly, they are getting new designs and designing our products into some of their forward-looking projects. So, it's tracking very well for that.

And the other piece that I would just mention, Bill touched on ICE Block, but our team is -- from the power side has been presenting at the Electronica show this week in Munich, and they had a really great demonstrations there, great customer meetings and a lot of that included the Advanced Power products which are -- the R&D is based out of the Canadian office now and the ICE Block is a big key to that project.

So, we're quite pleased with where the CUI-Canada acquisition is at right now from a positioning standpoint and what it's done for the value of the power segment.

Marco Rodriguez^ Got it. And then if you could talk a little bit about the margins that you're seeing here in the power and electric side. This is -- it's been a little while now where you've been trending kind of below your historical range, is that just overall weakness in the market, is the pricing -- are you losing some share, can you talk a little bit about that and then when you expect to maybe get back to a historical range or if that historical range, margin range rather is going to be shifting?

Daniel Ford^ Sure. I believe it's going to return to -- back up to the high 30s rather than being in these mid-30s that we are at this year. I think it will return to the higher 30s in the first half of 2017.

A couple of issues that have been impacting that are one, there's the product -- the core product out of Canada is a lower margin, mid 30% margin business. It's also been dragged down though by the oversupply and distribution that's in the marketplace right now or during this year really since Q4 of last year, so pricing has been more competitive through this year as there has been plenty of supply in the marketplace for competing products. So, we do expect though as we've started to see that turnaround as we've seen design wins and manufacturing started ticking back up for some of our core customers that we believe that can go back up

Marco Rodriguez^ Got it. And switching gears here real quick. I believe I heard you Bill, on the Snam opportunity, you mentioned something about a tariff situation, could you provide a little color on that?

William Clough^ Yes, it's relatively complex, but the plan that they rolled out to install these devices calls for them to buy the installation point with these high-end industry customers. At that point, where they connect to the gas system is currently owned by the customer and due to EU regulations that come into effect next year, the customer has to upgrade that connection, which is going to be quite costly. Snam is going in offering to buy that connection point from them and to install our device along with some other upgrades that they're going to do including flow computers and other things. And in order to do that, they also need to buy an access or an easement to get in and obviously maintain what they are installing.

There is no problem whatsoever if the customer voluntarily agrees to that, which they believe almost all customers will, because obviously they sell an asset that's going to cost them a lot of money starting next year, and so it's something that becomes a revenue generator as opposed to a cost. However, the energy authority over there says the problem arises with customers who do not want to participate. Those customers would be paying the same tariff as the customers who do participate, which they felt was a potential anti-trust violation, or what they what they are having to do is, design and implement a two-tiered tariff system, which they've done in the past. They did it when they changed from flow meters to flow computers, but it has to be instituted so that the customer who does not want to be participate pays a separate tariff, which would be designed to motivate them to participate frankly, but it would be separate from those who do participate would be in essence amortizing the cost for everybody across that tariff.

So again, it's complex and it is -- but it is something they have addressed before, but it's not unique to this situation, it's just something they have to do before they can move forward with the installation.

Marco Rodriguez^ And is this new regulation or tariff, was this something that just came up kind of out of the blue or was it always there, can you help me understand that?

William Clough^ Yes, it came up very unexpectedly according to what I heard from them. It's -- again, it's a socialist country, it has layer after layer of regulatory authority. They had all approvals necessary, including the energy regulatory authority, what they call the energy authorities. And they started to move forward and the energy authority raised this anti-trust issue. They went to the anti-trust authority, which is another group that they have over there, and the anti-trust authority said, "There's no problem. Not an issue, move forward." But the energy authority, still believe that it was and is a problem, and so they have to address it.

And as I mentioned, the way they address is through this two-tiered tariff. I mean, again, unfortunately or fortunately, it's part of doing business in the EU. EU is heavy on regulations and it is a largely socialist government that are very much in a regulatory-environment. They look for things like this and then companies got to deal with it.

Marco Rodriguez^ Got it. And then just last quick question. Just kind of a clarification, just want to make sure I heard correctly. For both businesses, the power and electric and the energy, you're expecting normal seasonality sequentially from this quarter, Q4?

William Clough^ Yes, exactly.

Operator^ Thank you. Our next question comes from the line of Gregg Hillman from First Wilshire Securities Management. Your line is open.

Gregg Hillman^ Yes, Bill, could you talk about the adoption of the PT gas analyzer for transmission systems in North America, is -- what will be the payback period for them versus Europe and what ducks would you have to line-up for there to be widespread adoption among transmission lines in North America?

William Clough^ Yes. Well, I think the opportunity in North America as we mentioned is more for process control. So, there are thousands and thousands of these big compressors that we would apply to and I think that would be our first entree into the market.

Now the issue with fiscal monitoring, which is what we are doing in Europe, in the U.S., is quite simple. They have under most contracts, there is no regulatory requirements, but both most contracts set forth that for a delivery product to anyone whether it be another transmission company, a distribution company or for anything else, you need to identify particularly the more complex hydrocarbons, these 3C, 4C, 5C mix. And there is no reason for that, but it's always been done that way. And we don't do that. We give the CV, we give the calorific value very accurately, but we don't break down the chemical components of the gas.

So in essence, we've had -- we've already gotten the AGA, the American Gas Association, to change their requirements, but the regulatory requirement has changed and it does not require these hydrocarbons or more complex hydrocarbons to be identified, but the industry as a whole has just always gotten it.

Now I've sat and I've had my technical people sit in front of numbers of engineers who tell us "Well, now your device might not apply to us because we really need those complex hydrocarbons identified." And you go why, and they go, "Well because we've always had that." We go, "Why do you need that?" "Well, we don't need it, I guess, but we've always had it."

So the fact is, it's not something that's needed. It's not something that's required regulatory or otherwise, but it is the way North America has operated for 60 years. So it really is an education process and we are doing that. We've got some white papers being prepared. We have people appearing in industry shows and other places to get out the word because there is really no need for this, and obviously our device is much cheaper, and much faster, and much more accurate than what they are using currently. But I think that's the thing we have to overcome. You don't have to overcome that in Europe; Europe, they're not interested. What they want in Europe is what we give them, which is the calorific value measurement and compressibility.

So, again, I think the adoption as a fiscal monitoring device is going to be a little slower over here, has been a little slower over here and that will continue because we do have to educate the industry.

Operator^ Thank you. Our next question comes from the line of Alex Blanton from Clear Harbor Asset Management. Your line is open.

Alex Blanton^ So just to be clear, you may have mentioned this, but these 400 units, have any been installed?

William Clough^ Yes. I can't tell you how many have been installed, but there have been a number installed. They are getting results back. So, there have been a number installed and they're all working perfectly. I just don't have a handle on how many have been installed, and frankly, I think they're not revealing that intentionally because again they are having this tariff issue, and I think they're keeping it not from us so much as from the authority.

Alex Blanton^ Okay. So if the installations that have been held up, and therefore they're holding up the deliveries.

William Clough^ Exactly. It's the installations that have been held up, not deliveries. We've delivered, they've been installed -- the process is we deliver the product to our distributors, Socrate. Socrate's mounts it on a back plate and plums it basically, that back plate is a 6 foot by foot stainless steel back plate, it's been shrunk wrapped, literally sealed in plastic and sent to the Tier 1 contractor. And then it's sent out from their warehouses to be installed. They are actually doing the installation. But the deliveries aren't -- we delivered everything. Socrate did the piping and put them on the back plate. The delay has been getting them from the Tier 1 contractor into the customers.

Alex Blanton^ And so they've held up ordering until they can solve the delivery?

William Clough^ Correct, exactly right.

Alex Blanton^ Okay. Second question is on the ethylene opportunity. Did you mention the dollar amount per installation?

Daniel Ford^ So it will vary by installation based on the -- really the design of the plant. The one that we just delivered though (inaudible - microphone inaccessible).

Alex Blanton^ How much, your signal is a little distorted sometimes, how much was that?

Daniel Ford^ It was about a $1.8 million project for this delivery. It will vary by plant based on their design scope and needs, how many sampling systems they require and the size of the plant, upwards (inaudible - microphone inaccessible).

Alex Blanton^ Well how much variability you anticipate, is $1.8 million the upper end or the lower end?

William Clough^ I think this was a representative plant, so I would assume that this sits right in the middle. I think that you're going to see some slightly lower than that and others slightly greater than that. I've been told that the -- for us, for our planning, that we can plan around $2 million per plant if we average it across all 54 or 55 plants and I think that's probably reasonable. This is a -- they try to pick a very representative plant to do this on.

Alex Blanton^ Okay. So, what phase are we in? It sounds to me like if they did all their plants, it would be over $100 million business, but at over what period and when would that start this kind of thing?

William Clough^ No idea. What I can tell you is that they are in testing. They're telling us if they have the results that they expect by the first part of 2017, they want to sit down and talk about rolling it out across their entire fleet of plants. We have not sat down and had that conversation.

Alex Blanton^ No, but they have said that they hope to have the results by the first part of 2017?

William Clough^ Correct.

Alex Blanton^ Okay. So then you would have a conversation. And if it’s a payback of, I don't know, I think you mentioned on a prior call, it was a matter of three months, is that correct?

William Clough^ Or less. As I understand it, the cost of shutting down a plant is about $10,000 an hour. And their shutdown is an average of anywhere from 24 hours to 72 hours. They are shutting those plants down. And as I mentioned, 8 times to 11 times a year. They expect to reduce that number from 8 to 11, down to 3 times to 4 times a year. That’s a very quick payback.

Alex Blanton^ Yes. Okay. So is there anything that would inhibit them just -- okay, we got good results from this, so let's do 10 more or let’s do 20 more, is there anything that gets in the way of that?

William Clough^ Other than results, I mean if the results are what we expect, there is nothing else. I mean without going into great detail, a $100 million investment for this company, the one we’re dealing with would be a drop in the bucket. They do not -- infrastructure cost of that doesn't mean anything to them. So, it certainly wouldn’t be an expense issue. Again, I don't know about their internal operations or what they do, but it seems to me that if we’re able to save them that kind of money that quickly then they would be very motivated to get these things out, and I think they will.

Alex Blanton^ Okay. If they do that, how would you anticipate the spreading to their competitors? How big is that total market?

William Clough^ I don't know the total market. I know that the ethylene industry is becoming bigger and bigger all the time because as I mentioned, it’s green energy. But I don't know the total market. Much like we have talked about penetrating Western Europe using Snam as our reference customer, we would use this customer the same way. They would be our reference customer and we would go out to the market in a big way with them as our reference customer. We’ve agreed to that, if the results are what we expect.

So, again, I think we would pursue it just like we are pursuing Western Europe. And I think how fast, again, I get back to it. It’s different from the GasPT in that the savings are immediate and quite dramatic. So, I think -- I would think the sales would be again quite immediate and quite dramatic.

Alex Blanton^ And where will these be manufactured and would you make them or would you farm that out?

William Clough^ Actually, that’s one of the products that Daily Thermetrics would make for us in North America.

Alex Blanton^ And their plants are where?

William Clough^ In Houston.

Alex Blanton^ So, the products will be made by your partner in Houston?

William Clough^ Correct.

Operator^ Thank you. (Operator Instructions) Our next question comes from the line of Andrew D'Silva from B. Riley. Your line is open.

Andrew D'Silva^ Just a couple of quick questions. The first one, you probably touched on this a little bit, but I just wanted to clarify. As far as the inventory issue went with the CUI-Canada customers, have you seen that resolve itself now over time and its demand returning, and is this a division you feel like should grow with legacy products next year?

Daniel Ford^ First part of the question, yes. We've -- those customers are all reordering now and they're reordering on more of a schedule -- scheduled basis, so, based around their production. So that is taking place now. It's not -- they've burned through the backlog of supply that they had over built-up prior to CUI's acquisition and just post to CUI's acquisition, so that's good.

Do we see it as a growth area? Yes, we do believe that this side can grow. I mentioned previously that the orders are tracking that those customers are actually starting to -- some of them are starting to purchase and have designed in other CUI products into their manufacturing processes. So, it's expanding outside of the CUI-Canada product line into the core CUI product we already had. And they're also -- really important is they're doing new designs in incorporating the CUI-Canada and CUI's existing products into new products going forward.

So, we see a lot of opportunity for growth there. It was -- the business was much larger, six, seven years ago before it went into decline following its -- really just management of sales and marketing by the former entity, Tectrol. So it was doing around a $100 million 10 years ago. We see it as being able to get back up in fairly a short time to a growth story. We believe we've gotten through the fixes that need to be done regarding production and SG&A and really repairing customer relationships. Now, it's just about going back to the market and proving out that that company or the CUI now provides a quality front end power supply that we've never offered before. So, we've been making those introductions and getting in front of customers both the previous Tectrol customers and CUI's existing customer base, so it definitely is a growth opportunity.

Andrew D'Silva^ Okay, great thanks for that. And then, just a clarification. So during the quarter, you sold 157 GasPT devices. I was wondering did you recognize that all as revenue during the quarter and when do you actually paid, is it once you deliver it to Socrate or is it after they get installed?

William Clough^ It's upon delivery. And it's net 60. So, again -- and they've been quite -- frankly, quite timely in payment, we haven't had an issue with that at all. And yes, we recognize those revenues on delivery.

Operator^ Ladies and gentlemen, I see no other questionnaires in the queue at this time, so I'd like to turn the call back over to management for closing comments.

William Clough^ Just in closing, thank you again everyone for your interest and support. We think that we are in very exciting times with both the energy and power divisions and we expect 2017 as I mentioned to be a very, very good year for us. We've got a whole lot of exciting projects going on, and then, obviously, we will keep you up-to-date as things develop. Again, thanks much and have a great day.

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