CUI Global, Inc. Q2 2018 Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q2 2018 CUI Global, Inc. Financial Results Conference Call. (Operator Instructions) I will now like to turn the call over to Sanjay Hurry, Investor Relations Counsel. You may begin.

Sanjay M. Hurry

Thank you. Good morning, and welcome to CUI Global Second Quarter 2018 Results Conference Call. A copy of the company's earnings press release and accompanying PowerPoint presentation to this call are available for download on the Events & Presentations page of the Investor Relations section of the CUI Global website.

With us on the call today are William Clough, President and Chief Executive Officer; and Daniel Ford, Chief Financial Officer. The purpose of today's call is to review the company's financial results for the second quarter and to provide you with management's perspective on the second half of fiscal 2018. Following management's remarks, the call will be open to question and answers. A telephonic replay of this call will be made available until August 21. You may also access the archived webcast and accompanying PowerPoint at any time on the Investor Relations section of the CUI Global website.

As a reminder, this call will contain certain forward-looking statements made within the meaning of Section 27A of the Securities Act of 1933 as amended and Section 21E of the Securities and Exchange Act of 1934 as amended. Such statements are subject to risks and uncertainties that could cause actual results to vary materially from those projected in forward-looking statements. Company may experience significant fluctuations in future operating results due to a number of economic, competitive and other factors including, among other things, company's reliance on third-party manufacturers and suppliers, government agency, budgetary and political constraints, new or increased competition, changes in market demand and the performance or liability of its products. These and other factors could cause operating results to vary significantly from those in prior periods and to those projected in forward-looking statements. Additional information with respect to these and other factors which could materially affect the company and its operations are included in certain forms the company has filed with the Securities and Exchange Commission.

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

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

Thank you, Sanjay. Good morning, everyone, and thank you for joining us on our fiscal second quarter 2018 results conference call. I'll begin this morning with a brief overview of our performance for the quarter, after which Dan will review your financial results in greater detail. Following Dan's remarks, I will conclude the call with some commentary on our business trajectory for the second half of this year.

To begin, our consolidated revenues for the second quarter reflect strong demand in our Power and Electromechanical segment that offset slow uptake in our Energy segment as compared to the prior period. As Dan will discuss in his prepared remarks, net loss for the quarter includes a further

$1.3 million goodwill impairment charge against Orbital-UK. It also includes approximately $400,000 of foreign exchange loss and $200,000 in marketing costs associated with our well-attended open house event in the U.K. and our participation in the World Gas Conference in Washington, D.C. Our Power segment was again a standout performer in quarter, with momentum sustained by strong end markets and increased distribution. We continue to see strong demand and broad growth across our entire product portfolio.

Segment revenues increased approximately 12% over the prior period that was driven by high distributor sales, volume, new distribution partners such as Master Electronics last quarter and Arrow last year are driving greater order flow as these relationships maturing and expand. Power segment backlog at quarter-end was $26.5 million, up slightly as compared to $26.1 million at March 31, and up 31% from $20.2 million at December 31. Strength in Power backlog is being largely driven by our distribution channel customers and we anticipate this momentum to continue to translate to the segment's quarterly revenue performance.

In our Energy segment, we anticipated a soft quarter and first half as the bulk of Orbital-UK's projects are scheduled for the second half of the year due to customer schedules and associated delays in the RHI approval taking place in late May for Biomethane project incentives. An expected stronger second half performance is built into Energy backlog, which has increased 34% since the start of the year and has done so without the benefit of new orders from our Italy contact. Energy segment backlog stood at $16.9 million at quarter-end.

Our Energy segment performance also reflects slow uptake of our products across the many avenues of growth we've cultivated over the past 2 years as we await a restart to our Italy contract. We continue to seed the market with customers that can scale their orders as their confidence in our innovative gas products builds.

In the second quarter, we saw signs of traction with a series of orders for Biomethane applications in the U.K. following the recent broader certification of our GasPT analyzer by U.K. energy regulator, Ofgem.

After Dan's review, I'll have more to say on how the U.K.'s commitment to moving further away from traditional fossil fuel energy and towards more bio environmentally friendly alternate energy sources together with Orbital-UK's long-standing relationship with energy operators in country positions us to benefit from tailwinds in this market.

Now let me turn the call over to Dan Ford, our CFO, who will take you through our financial results in greater detail. Dan.

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

Thank you, Bill, and good morning, everyone.

Before I review our second quarter results, as a reminder, CUI Global has adopted the new revenue recognition standard known as ASC Topic 606 for fiscal 2018. All financials presented today as well as those found in the PowerPoint presentation that accompanies this call are based on these new revenue rules, unless otherwise stated. As such, our financial results for the second quarter are not directly comparable to those of the year-ago period. They're reported under the old revenue rules.

To give you an apples-to-apples comparison, we're also providing for your convenience what our second quarter and year-to-date results for 2018 would have been as reported under the old revenue rules. Financial results presented under the old revenue rules are directly comparable to 2017 and can also be found in the PowerPoint presentation. I refer you to notes 2 and 3 of our condensed consolidated financial statements found in our Form 10-Q for the quarter ended June 30, 2018, for a detailed explanation of revenue recognition under both the old and new rules and its cumulative effect on our results.

Turning toward our consolidated results for the quarter, total revenue was $23.1 million as compared to $22.5 million for the second quarter of 2017, reflecting a $2.1 million increase in revenues from the Power and Electromechanical segment, offset by a $1.5 million decrease in revenue in our Energy segment. Largely as a result of lower contribution from our Energy segment, consolidated gross profit margin was 350 basis points below last year at 33% for the quarter ended. As a reminder, our Energy segment experiences improved margins when it sells more of its leading technology solutions, including GasPT and VE sampling systems, which offset lower-margin integration-type work. Resulting from the lower margin, consolidated gross profit decreased in the second quarter of 2018 to $7.6 million, compared to $8.2 million in the prior year period.

Consolidated selling, general and administrative expenses for the second quarter were $9.2 million, an increase of $0.5 million or 6% compared to the prior year Q2, reflecting higher exchange rates contributing to higher translated costs at Orbital-UK and increased activities in support of the increased revenues and marketing efforts across both segments during Q2 2018, including our attendance and booth presentation at the recent World Gas Conference as well as the open house held at our U.K. facility. While SG&A expenses increased in absolute dollar terms, as a percent of revenue, SG&A increased 1 percentage of revenue for the quarter-end and improved approximately 2 percentage of revenue for the year-to-date period.

Adjusted EBITDA loss for the second quarter was $2.4 million compared to $0.8 million in the second quarter of 2017. For the second quarter, we recorded a $1.3 million goodwill impairment charge associated with our Orbital-UK subsidiary to reflect the ongoing and longer-than-expected temporary halt in shipping of our GasPT devices under our contract with the Italian customer and a generally slow market in the U.K. related to Brexit, including a slowed biogas industry symbolized by an extended delay in the UK's approval of the domestic and nondomestic Renewable Heat Incentive scheme until late May. As you're aware, we also incurred an impairment charge in the fourth quarter of 2017.

We test for impairment in the second quarter of each year and when events or circumstances indicate that the carrying amount of goodwill exceeds its fair value and may not be recoverable as was the case in Q4. The remaining goodwill related to Orbital-UK amounts to $3.2 million. As a result of this impairment charge, net loss for the quarter was $4.8 million or $0.17 per share compared to a net loss of $1.6 million or $0.07 per share for the same period last year.

Turning to our segment revenue and gross margin. I'll start with our Power and Electromechanical segment. Revenues for the quarter were $20.3 million compared to $18.2 million last year, an increase of 12%. On a sequential basis, Power and Electromechanical segment revenues increased 19%, reflecting continued strong orders within the segment and the associated deliveries as well as normal seasonality in the industry that typically troughs in Q4 and peaks in Q2 and Q3. We continue to benefit from the electronics market upcycle, the broader base of business we've established over the past several years with new distribution partners as well as from new design wins and new product introductions. Gross profit for the second quarter was $7.3 million, or 36%, essentially the same gross profit percentage on higher revenues than the prior year period.

Our Energy segment produced revenues of $2.8 million down from the $4.3 million we reported last year. The year-over-year variance reflects the timing of customer project schedules and the generally slower U.K. market that has continued into 2018. Bill will provide some commentary shortly on the passage of the RHI incentive program in the U.K. that we expect will result in improved order flow in the second half of the year.

In our Energy segment, revenues for the quarter were more heavily weighted toward lower-margin integration projects. As a result of the decreased revenues and lower margin mix, gross margin for the quarter fell to 14% from 39% last year. Further, increased integration volumes spread fixed costs that impact gross profits and the second half of 2018 is forecast to have a significant increase in these type of projects, particularly through the U.K. operations as the current customer backlog demonstrates.

Consolidated backlog was $43.4 million at quarter-end compared to $32.8 million at December 31, 2017. Backlog for the Power and Electromechanical segment was $26.5 million, an increase of $6.3 million compared to $20.2 million at December 31. This increase reflects the inclusion of the ICE Block order received in Q1 2018 as well as the continued uptake in the power market. The Energy segment backlog at quarter-end increased $4.3 million to $16.9 million compared to $12.6 million at December 31, 2017.

For the first half of the year, we generated consolidated revenue of $45.1 million, compared to $40.3 million in the same period last year, with increased Power and Electromechanical segment revenue offset by slightly lower Energy segment revenue. Power and Electromechanical revenue grew 17% to $37.3 million from $31.8 million in the prior period. Energy revenue was $7.8 million compared to $8.5 million last year, a 9% decline. Consolidated gross profit for the 6-month period was essentially even at $14.2 million, compared to $13.9 million in the prior period, reflecting unfavorable segment mix associated with lower sales of higher-margin products in our Energy segment and the decline in Energy segment revenues. Likewise, consolidated gross margin fell from 35% to 32%.

On a segment basis, Power and Electromechanical delivered a gross margin of 33% or 100 basis points below last year's 34%. This decrease in margin for the Power and Electromechanical segment was primarily the result of the approximately $900,000 Q1 royalty expense to Virtual Power Systems included in cost of revenues. Energy segment reported a gross margin of 22% compared to 35% in the prior period, reflecting the mix of lower-margin integration projects during the quarter and delays on higher-value integration projects to the second half of 2018.

SG&A increased $1.2 million in the 6-month period to $18.4 million from $17.3 million in the prior period, reflecting increased costs in both our Power and Electromechanical and the Energy segment that were primarily due to higher selling expenses on higher Power and Electromechanical segment sales and higher professional fees in the Energy segment.

We expect SG&A expenses over the balance of the second half of 2018 to decrease slightly associated with various initiatives and the completion during Q2 of the World Gas Conference and open house events and the related cost in the Energy segment. Research and development was relatively flat at $1.4 million, compared to $1.2 million in the prior period. We expect research and development over the balance of the year to continue at its current rate.

As a result of the increase in SG&A, the adjusted EBITDA loss widened to $5.2 million, compared to $4 million in this the first half of 2017. Net loss for the year was $8 million or $0.28 per share compared to a net loss of $5.4 million or $0.26 per share in the prior period. As a reminder, net loss for the first half of the year includes a goodwill impairment charge of $1.3 million.

In terms of our balance sheet, we ended the quarter with cash, cash equivalents and restricted cash of $7.8 million. This compares to $12.6 million as of December 31, 2017. Supplementing our cash balances, we have borrowing capacity available to us in the form of our undrawn $4 million line of credit with Wells Fargo and about $1.2 million left available of an approximate $2 million overdraft facility also at Wells Fargo maintained by Orbital-UK.

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

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

Thank you, Dan. As we move past the halfway point to the year, our strategy remains unchanged, mainly to pursue large addressable markets with disruptive technologies found in our 2 segments to deliver higher and sustainable growth to our shareholders.

In our Power segment, we continue to move to extend the market footprint and promote our ICE technologies in the marketplace following the receipt of the UL and TUV certifications. We are in the marketplace today with channel partners to drive awareness and adoption of the ICE Switch and ICE Block and our message is a compelling one that is resonating with the data center operators. Namely that the ICE technology can provide data centers with the ability to embed intelligent visibility and control automation, instantly unlocking previously unusable power capacity for major operational and bottom line benefits. Staying with ICE for a moment, we strengthened and extended our partnership with Virtual Power Systems, or VPS, subsequent to the close of the quarter. Through an amended agreement with substantially de-risked the partnership with VPS while also positioning us to benefit from secular trends within the data center marketplace to utilize software-defined power infrastructure to simplify the deployment and management of resources. Separately, we made an investment of $500,000 in a convertible note receivable with VPS to support the two companies' continued collaboration and development of industry transforming SDP technologies.

In brief, we renegotiated and extended the exclusive agreement through 2024, with an automatic renewal provision. We also eliminated a $1.4 million buyout provision and strengthened the agreement to increase protections around our use of the VPS software and technology in our hardware applications.

The amended agreement enables us to benefit from the data center market's adoption of our ICE technology over the long-term. Of equal significance, with our investment in VPS, we are supporting VPS's development of hyper-converged power infrastructure solutions. Hyper-converged infrastructure is a software-defined solution that simplifies the deployment and management of data center resources: compute, storage, networking and power. The IT industry views such a solution as a paradigm shift given their ability to create significant operational and economic benefits for data center operators. According to a January 2018 report by market research firm Stratistics MRC, the global hyper-converged infrastructure market is expected to reach $17 billion in 2023 from $1.5 billion in 2016.

Turning to our Energy segment, I noted earlier that we're seeing traction in the U.K. market for biomethane applications, and those orders coincide with the broader certification of our GasPT. Over the past several years, the regulatory, statutory and CapEx environments of U.K. have been driving towards an acceleration in the pace of adoption of renewable energy sources such as biomethane.

On May 22 of this year, the U.K. passed its domestic Renewable Heat Incentive, a feed-in tariff designed to incent biomethane production. As a consequence, we have seen the RHI catalyze the incremental demand for both our integration expertise and the energy products. You've likely seen that the bulk of our recent press releases have been U.K. biomethane-related, attesting to strengthening order flow for our products. With numerous biomethane facilities planned over the next several years in the U.K. alone, we are well-positioned to benefit from the U.K.'s evolving energy policy.

I draw you attention to one of our recent announcements, which we take as a significant development in the industry's adoption of GasPT. We recently secured an award for the U.K. from one of Europe's leading manufacturers of biomethane-to-grid solutions for use of our GasPT technology as a direct replacement for its gas analyzers.

In the second half of 2018, we expect to make additional announcements regarding the use of our GasPT and VE technologies as a replacement for the legacy gas chromatograph technology, as operators across the U.K. recognize the advantages, both from an economic and accuracy perspective, of our GasPT analyzer. Staying with Europe for a moment longer, let me update you on our Italy project.

With the recent formation of an Italian government, our partner Socrates has made operational inquiries to us in support of a restart of the re-metering project. Discussions around build schedules and lead times have taken place, however, I want to stress that no timetable has been communicated to us. This is nevertheless a positive development, though we are cognizant of the fact that Italy had been without a government for several months, and the new government has a backlog of business to which it must attend.

From our perspective, we are ready to begin Italian deliveries immediately upon notifications from Socrates. I would, however, remind everyone that Socrates has approximately 350 GasPT units, some portion of which will need to be progressed through installations before a second purchase order is issued to us.

As a further reminder, the Italian re-metering project is fully funded and given the advantages of GasPT from an ROI and technology standpoint, our device remains integral to the gas operator's infrastructural plans. A restart of the Italy project remains a when and not an if, and when it does, it will have a significant positive impact on our future revenues, earnings and cash flows.

Our efforts to seed the market with customers that can scale their orders led to a signing of a memorandum of understanding with SAMSON AG, subsequent to the close of the quarter. SAMSON, with its more than 4,000 employees and facilities in 66-plus countries is a leader in flow control solutions in the energy market. Its reputation for innovative technology is peerless and its reach global.

With this MoU, we established our first global sales and distribution for our GasPT, VE technology and combined GasPTi analyzer can gain access to previously untapped large gas markets such as Russia, China, Africa and South America. We anticipate signing a definitive agreement to formalize our partnership in the next 60 days with an agreement that will include Samson's unit commitments for 2019.

Turning to North America, our newly opened Houston facility is the focal point for our efforts to drive awareness and adoption of our energy products in that geography. We are pursuing preferred vendor status with all major gas operators in North America, the securing of which would drive more project work to us given our much larger facility and increase the opportunities for higher-margin integrated sales - project and product - to these prospective customers.

We are also on track in securing North American certifications for our GasPT through measurement to Canada and are still progressing field trials with a large Canadian energy operator.

To conclude my remarks this morning, I hope to have given you a sense of the breadth and depth of our opportunity-set across both of our business segments. Momentum is building in our Energy segment with clear catalysts ahead and as we develop new geographies for additional opportunities.

Our Power segment is seeing sustained demand from strong end markets, and as we progress the initial rollout of our ICE solutions. Together, our two segments put us on a path of growing and sustained revenue growth and ultimately profitability.

Thank you for your time and attention this morning. Operator, please open the call to questions.

QUESTIONS AND ANSWERS

Operator

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

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

Maybe just -- I want to start with SAMSON and that MoU. It sounds like optimistic that you get something done here pretty quickly, but just curious, I mean how do you view that playing out? I mean is this something where it sounds like it's pretty detailed, they're very familiar with your technologies. Is this something that you expect to be a contributor even in 2018, more meaningful in '19, or is this one where it's similar to some of your other distribution agreement where it's a wait and see before you know that it's going to be successful or not?

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

You know I'm pretty enthusiastic about SAMSON. They're big operator. They're very familiar with the technology, and they came to us to put this deal together. We're actually tentatively scheduled to announce the formal agreement at the Gas Tech [Conference] in Spain in September. So they're pushing hard to get that agreement in place by then. If that does occur, I expect to see some impact this year towards the end of this year. Certainly, the big impact we will be in 2019, but again, I think we could see units rolling out later this year. They want to, in essence, takeover our distribution network absent North American and the U.K. We would keep that, but they want to take over the world wide global distribution of the product, and they're quite well-positioned to do that. So I think they're -- this could be a very exciting opportunity for us.

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

Got it. Maybe just turning to Orbital and specifically North America with the new facility. I know the Energy, the order levels were where you wanted in Q2, but I'm just curious, I mean now that you've got that bigger facility, what the pipeline's looking like? But also when you look at that pipeline, is that one that includes integration work but also your gas products? Or maybe you could just give the mix of how you think that plays out going forward?

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

Yes, the backlog right now is up 34% from the end of last year to today. And that 34% frankly is largely in the U.K., because we've had a delay in their biomethane projects because of that RHI delay.

The Houston facility is continuing to grow at a pretty good pace. They are -- they haven't slowed down at all, and we have seen it hitting bigger uptick in projects as the new facility has come online. Not -- very little of that -- frankly, that backlog is the new technology. There are some GasPTs in there associated with the biomethane, there's also a project in for National Grid to replace a bunch of low-end gas chromatographs with the GasPT. So there is some GasPT revenues in that backlog, but predominantly, it is all integration work. So any of these bigger projects, any of the commitments by SAMSON or obviously the restart of the Italian project will dramatically shift the backlog and the mix of products going out.

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

And the conservations you're having with the market out of the Houston facility, I mean is that something that you anticipate changes over time that it does include those gas products? Or should we think of that as that really is going to be an installation hub for you?

William J. Clough - CUI Global, Inc. - Chairman, CEO, President & General Counsel No,

no, they are...

Eric Andrew Stine - Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst I'm

sorry integration. I apologize, integration.

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

Yes, they're definitely pushing product sales, in fact, they’re the ones dealing almost exclusively with Canada, for example, so they are -- they're definitely pushing product sales, and they're seeing some demand that's trying to ramp up. We've had re-orders as we mentioned in a couple press releases, we've got re-orders from the big compressor group that we are dealing with in the Northeast. So yes, the all North American product sales go through Houston.

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

Okay. Maybe last one for Dan. I know that you, last call, you had talked about your expectation that you'll be cash flow positive in the second half, just wondering if that's still your plan?

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

That's what we're still pushing for, yes, that we're working towards that, and as you know, the Energy segment is significantly back-half weighted, so that's really going to improve the position of the company, operating and cash wise. So that's what we're pushing towards, yes.

Operator

Our next question is from Liam Burke with B. Riley FBR.

Liam Dalton Burke - B. Riley FBR, Inc., Research Division - Analyst

Bill, could we talk a little bit about the ICE system. You talked about a lot of interest from the large providers. How's the deployment going with existing commitments? And could you give us a sense as to how close you are to looking at -- new orders from new customers?

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

Sure. We are under fairly restricted NDAs about naming customers. I can tell you because VPS has named them, that SAP is now rolling the product out. They [SAP] were going to do a proof-of-concept and instead of doing a proof-of-concept, they're [SAP] actually rolling out an initial deployment of one of their smaller data centers. So we have SAP. We've talked in the past about Intel. They are on board. But we have another probably 7 or 8 beta testers, if you will, although, it's a product not a beta product, that's out there, and we're seeing good adoption. These are new -- a very new technology, but it addresses a very significant problem in the data center market, which is energy and energy usage. So I think that as time goes on, we're going to see more and more traction develop. We expect to see orders developing towards the last half of this year with deliveries starting the first and second quarter of next year.

Liam Dalton Burke - B. Riley FBR, Inc., Research Division - Analyst

Great. And getting back to SAMSON. The commitment would be to be your exclusive distributor globally and are they more of a systems integrator or a straight distributor? Or is there technology sophistication on their part?

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

Yes, they are 107-year old German manufacturing company. What they do is they manufacture valve arrays, large pipeline components and analyzers for the oil, gas and petrochemical industry. They-are very, very well known, particularly in Europe and South America. They're very, very effective in what they deliver and what's happened is, over the course of the last year, 1.5 years, they have changed their philosophy and instead of being a component provider, they want to now be a systems provider. They want to provide entire solutions, and the GasPT fit directly into that change in business, and that's what they're working towards.

So they have already 4,000 employees across 66 countries, so they're very much worldwide. They have manufacturing facilities in India, they have actual manufacturing facilities in China and in the Russia and then, of course, their large manufacturing operation is in Germany, in Frankfurt. But what they are looking to do, what they would like to do is be our worldwide exclusive distribution. We have basically told them they're going to earn that, and the earning is going to be showing what they can do taking over the distributor network outside of North America and the U.K., where we're already very present. And that's why I think the agreement that we come up with and that we hope to announce, we'll have unit commitments, we'll have things that they're going to have to meet, milestones they're going to have to meet if they want to move forward and become the kind of partner that we hope they will be.

Operator

(Operator Instructions) Our next question is from Rob Brown with Lake Street Capital.

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

On the Samson deal, if you get orders, are those stocking orders for them? Are those orders that go into systems that they're deploying?

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

Well, it'll be stocking orders for them. In other words, orders will go to them as a sell-through not a sell-to. But they will be generally used as components for systems they'll be selling on to their customers. They have a large array of customers that we have no contact with now, things like Nestlé's where they use huge amounts of gas to roast coffee beans. They are big representatives in the glass and ceramics businesses throughout Europe, so they're going to have the ability to enter into systems that we would not have any focus on at all, and again, I think that largely, those stocking products will be used for their end users.

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

Okay, good thank you. And then on the U.K. biogas market, you received certification. I guess, could you just give us a bit more color on how that market is developing now that you have certification? You said there is a bit of delay. What's the -- what's kind of the next steps? And is there anything more to do on the government side? Or do you -- just a matter of the market developing at this point?

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

Yes, it's the market developing. We've already got and we've announced this as we got -- we've already got -- there's around, I believe, 7 or 8 units that we're putting together right now. There about GBP 0.5 million a piece about $750,000 apiece. We're also getting orders from other entities who are building the skids for our GasPTi, which is being used now because of the Ofgem certification. But really, the delay was getting the approval through the parliament.

As you remember, Theresa May called for a new government, which ended up late last year causing the U.K. government to, in essence, take a pause for 3 or 4 months, and they're now catching up with all sorts of things. RHI was one of those things. They passed it on May 22. So now you have a bunch of people, big companies, really major companies who are all putting together skids, and what we've done is really gone after the market with our expertise and incentivized people to place orders. We think there'll be as many as 21 to 24 units let out before the end of this year. I think we've already gotten bids on 14 or 15 of those. I think we've -- like I said, we've captured probably 8 to 10 of those. We think we'll get the large majority of them. And then the build start, but again, everything was contingent on the RHI being passed. That has passed, and now it's just a matter of getting the individual projects going.

Operator

(Operator Instructions) And we have a question from Mike Wallace with White Pine Capital.

Michael Scott Wallace - White Pine Capital, LLC - CIO, Managing Partner, Principal and Portfolio Manager

Thinking about the Energy margins second half '18 here. How do you see them progressing as you increase utilization in Houston and U.K.?

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

Back up to the low 30s. This quarter was exceptionally lower due to the, just lack of volume going through out of the U.K. office to the scheduled customers, so we should see that returning quite significantly back to the 30s.

Michael Scott Wallace - White Pine Capital, LLC - CIO, Managing Partner, Principal and Portfolio Manager Over the

mid-30s sort of what – what are you thinking?

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

Low to mid 30s, that's what we're expecting to see. And then as GasPT -- should GasPT ramp up then that'll have a bigger impact on it.

Michael Scott Wallace - White Pine Capital, LLC - CIO, Managing Partner, Principal and Portfolio Manager Okay. So

GasPT could add to the low 30s?

Daniel N. Ford - CUI Global, Inc. - CFO That's

correct.

Michael Scott Wallace - White Pine Capital, LLC - CIO, Managing Partner, Principal and Portfolio Manager Hello?

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

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

Yes, that is correct, I said. Sorry, it must not have come through.

Michael Scott Wallace - White Pine Capital, LLC - CIO, Managing Partner, Principal and Portfolio Manager

And after the agreement, the new agreement with VPS, does that agreement change the margin structure with them?

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

Doesn't change the margin structure. It does increase the term of the agreement exclusivity. It increases our rights to retain some of the IP that we've developed on our end and protect our developments there even beyond the term of the agreement. So it's more about extending the exclusively and protecting IP, but the economics are more or less the same.

Michael Scott Wallace - White Pine Capital, LLC - CIO, Managing Partner, Principal and Portfolio Manager

The investment you made, tell us a bit more about that.

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

Basically what we did is we got involved with them. It's a convertible note that will give us an equity interest in the company. It allows us to have, we believe, more input into what they do and where they do their sales and whatnot, and I think it also -- it creates stronger partnership. It was the way that we got them to agree to withdraw the provision regarding the potential release [of us from the previous agreement]. It also, as Dan mentioned, protected us in the area of our IP. And, basically created a much bigger and stronger partnership.

Operator

And I'm showing no further questions. I will now like to turn the call back to Bill Clough for any further remarks.

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

Just in conclusion, I've said from the beginning of the year that this second half of the year should be very strong second half for us. We still see that as being the case. We think that we're going to see additional projects with both the Energy segment and additional growth in the electronics division, I think as evidenced by the growth in the backlog in both segments. So I look forward to talking to you next quarter and again, if there are any questions or anything that anybody need, you're certainly welcomed to call us individually. Again, thank you for your support, and that ends our conference call.

Operator

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