# CUI Global Inc. Q3 2018 Earnings Conference Call - Transcript

## 7 November 2018

## CORPORATE PARTICIPANTS

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

## CONFERENCE CALL PARTICIPANTS

- Eric Andrew Stine - Craig-Hallum - Senior Research Analyst in the Equity Research department
- Robert Duncan Brown - Lake Street Capital Markets, LLC, Research Division - Senior Research Analyst
- Edward John Stacey - Proactive Investor UK Limited - Research Analyst

## PRESENTATION

- Operator - -

  Good day, ladies and gentlemen, and welcome to the Third Quarter 2018 CUI Global Financial Results Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-session and instructions will follow at that time.

  (Operator Instructions) As a reminder, today's conference is being recorded.

  I would now like to introduce your host for today's call Mr. Sanjay Hurry, Investor Relations Counsel. Mr. Hurry, you may begin.

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

  Thank you, operator. Good morning, and welcome to CUI Global's Third 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 in 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 third quarter and to provide you with management's perspective on the balance of fiscal 2018 and an early view into 2019. Following management's remarks, the call will be opened to question and answers.

  A telephonic replay of this call will be made available until November 22. You may also access the archived webcast and accompanying PowerPoint at any time on the Investor Relations section of the CUI Global website.

As a reminder, this call will contain certain forward-looking statements made within the meaning of Section 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, the 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 factors and others 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 said, I'd like to hand the call over 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 third quarter 2018 results conference call. I am very pleased to report an excellent start to the second half of the year with higher consolidated revenues and smaller net losses, both sequentially and in a year-over-year basis. Our performance was driven by a very strong rebound in the Energy segment's revenues, as anticipated, when we spoke on our second quarter call.

I'll begin this morning with a brief overview of segment performances for the quarter, after which Dan will review our financial results. Following Dan's remarks, I will conclude the call with an update on both our business segments with a focus on the progression of initiatives to drive broader adoption of our Energy products and how that positions us going forward into 2019.

To begin, our Power and Electromechanical segment continues to perform well. On a year-over-year basis, segment revenue was up about 17%, due primarily to higher distributor sales volume resulting from aggressive product expansion across all categories in prior quarters. Within this segment, we saw a strong performance by our Power group to do a general investment in inventory industry-wide in advance of recently implemented tariffs.

Solid performance in the Power group is also reflected in backlog at quarter-end of $25.6 million, which is up about 27% year-to-date. In our Energy segment, revenue was flat year-over-year and up about 84% sequentially as backlog converted to revenue with customers delivery schedules timed to take advantage of the RHI biomethane project initiatives that passed in late

May.

Energy backlog is up 27% year-to-date without the benefit of new orders from our GasPT contract in Italy, rather the increase is being driven by the cultivation of energy product sales in other geographies, integration project wins at our new Houston facility and because of the RHI scheme.

Now, let me turn the call over to our Chief Financial Officer, Dan Ford. Dan?

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

Thank you, Bill, and good morning everyone. Before I review our third quarter results, I want to remind you that CUI Global has adopted the new revenue accounting standard known of 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 third quarter are not directly comparable to those of the year ago period that we reported under the old revenue rules.

To give you an apples-to-apples comparison, we are also providing our third quarter and year-to-date results for 2018 as reported under the old revenue rules compared to 2017. You can find the table on Slide 4 in the PowerPoint presentation. Also notes 2 and 3 of our condensed consolidated financial statements in our Form 10-Q for the quarter ended September 30, 2018 give you a detailed explanation of revenue recognition under both the old and new rules and its cumulative effect on our results.

Turning to our consolidated results, total revenue for the quarter increased $2.9 million or 14% to $24.7 million from $21.8 million in the prior period. This improvement in total revenue was almost entirely attributable to our Power and Electromechanical segment. Revenue increased $1.6 million sequentially with the increase attributable to the Energy segment.

Consolidated gross margin of 33.4% for the quarter was down slightly from the prior period gross profit margin of 34.1% on higher total revenue, offset by a higher contribution of lower margin integration type project work within our Energy segment. As a reminder, gross margin in our Energy segment improves on a mix of its leading technology solutions including GasPT and VE sampling systems increases, offsetting lower margin integration type project work. Consolidated gross profit increased for the quarter by $822,000 to $8.3 million compared to $7.4 million in the prior period.

Consolidated SG&A expenses for the third quarter were $8.5 million, a $300,000 increase, reflecting increased costs in both the Power and Electromechanical and the Energy segments. While SG&A expenses increased in absolute dollar terms; as a percentage of revenue, SG&A decreased 3% of revenue for the quarter to 34%.

EBITDA loss for the third quarter was $0.8 million compared to $1.2 million in the third quarter of 2017. Adjusted EBITDA loss for the third quarter was $0.8 million compared to $1.1 million in the third quarter of 2017.

Turning to our segment revenue and gross margin. I'll start with our Power and Electromechanical segment. Revenues for the quarter were $19.6 million compared to $16.7 million last year, an increase of 17%. On a sequential basis, Power and Electromechanical segment revenues decreased 4% due to relatively flat sales to direct customers. Gross profit for the third quarter was $6.9 million or 35.4%, reflecting a 130 basis point increase on better sales mix of higher margin products over the prior period.

Our Energy segment produced revenues of $5.2 million, up slightly from last year. As Bill referenced, customers timed their delivery schedules for lower margin integration work for the second half of 2018 in order to secured project funding under the RHI scheme that passed in May, as demonstrated by the $2.3 million sequential increase in revenues. As a result, Energy segment gross margin for the quarter fell to 25.6% from 34.3% last year. We expect a similar gross margin profile for the Energy segment for the fourth quarter.

Consolidated backlog was $41.6 million at quarter end compared to $32.8 million at December 31, 2017, an increase of $8.8 million. Backlog for the Power and Electromechanical segment was $25.6 million, an increase of $5.4 million compared to $20.2 million at December 31, 2017. This increase reflects ongoing strength in the segment along with ICE Technology backlog from the order received in Q1 2018. Energy segment backlog at quarter-end increased $3.4 million to $16 million compared to $12.6 million at December 31, 2017.

For the 9-months ended September 30, 2018, we generated consolidated revenue of $69.8 million compared to $62.1 million in the same period last year, an increase of 12%. This increase was due to higher revenues in our Power and Electromechanical segment that were offset by slightly lower Energy segment revenue. Power and Electromechanical revenue grew 17% to $56.9 million from $48.5 million in the prior period. Energy segment revenue was $12.9 million compared to $13.6 million last year, a 5% decline.

Consolidated gross profit for the 9-month period increased by $1.1 million or 5% to $22.5 compared to $21.3 million in the prior period. Consolidated gross margin fell from 34.4% to 32.2%.

On a segment basis, Power and Electromechanical delivered a gross margin that was essentially unchanged at 34.1% compared to 34.3%, despite an approximately $900,000 royalty expense we paid in the first quarter related to revenues on the ICE Technology sales. Energy segment reported a gross margin of 23.6% compared to 34.6% in the prior period, reflecting the mix of lower margin integration projects year-to-date.

SG&A increased $1.5 million in the 9-month period to $26.9 million from $25.5 million in the prior period. Reflecting increased costs in both our Power and Electromechanical and the Energy segment that are 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 year to be around $9 million.

Research and development was relatively flat at $2.1 million compared to $1.9 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 increased to $5.9

million compared to $5.1 million in the same period last year.

Net loss for the year was $9.6 million or $0.34 per share compared to a net loss of $7.3 million or $0.35 per share in the prior period. As a reminder, net loss for the 9-months of 2018 includes a non-cash goodwill impairment charge of $1.3 million.

Turning to our balance sheet, for the 9-months of 2018, we have used $9.4 million of cash, $4 million of which was for working capital, the majority of that utilized for increases -- trade accounts receivable and inventory associated with the increase in revenue as well as building inventory ahead of the implementation of recent tariffs on importation of Power and Electromechanical products.

We also invested $1 million in CapEx and also $500,000 on the convertible note in our ICE Technology partner Virtual Power Systems as part of our relationship building with EPS that Bill will discuss in further detail. We ended the quarter with cash, cash equivalents and restricted cash of $3.2 million, this compares to $12.6 million as of December 31, 2017. We are working diligently on revenue opportunities that create a path to cash flow breakeven and are concurrently moving to ensure our financial flexibility and extend our cash runway.

We recently entered into an LOI to sell our Tualatin headquarters which, after paying off the mortgage, would net approximately $4.5 million in cash. We expect to close this transaction in the fourth quarter. We also have borrowing capacity available to us of $3.3 million available on our $4 million line of credit with Wells Fargo and about $0.7 million left available of an approximate $2 million overdraft facility also with Wells Fargo maintained by Orbital-UK.

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

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

Thank you, Dan. As you've heard from Dan's prepared remarks, we are very cognizant about the state of our cash reserves. To that end, we are working diligently toward cash flow breakeven while the sale of our Tualatin building, together with other non-dilutive options available to us, allows us to extend our cash run rate with no dilution to shareholders, as we guide the company through multiple inflection points ahead.

As we look to the balance of the year and into fiscal 2019, the disruptive nature of technologies across our 2 business segments and their relevance to large addressable markets remains compelling and unchanged. Cumulatively, they offers a path of multi-year revenue and earnings growth. For the balance of the year, we expect business momentum to be sustained across our 2 segments and deliver a strong second half of the year as compared to the first half.

In our Power and Electromechanical segment, prior investments made in the establishment of new distribution partners, new design wins, and new product introductions should continue to drive the performance of this segment and its backlog. As Dan noted, we built up inventory in the third quarter to curb the effect of tariffs on this segment. The issue of tariffs is one we continue to closely monitor as nearly every product in our electronics business is affected.

We have passed increased costs along to customers and are evaluating options such as more offshore selling to mitigate price increases. I would note that product out of our Toronto facility, including our ICE Technology is not subject to the increased tariffs.

In our Energy segment, we are seeing strong uptake in biomethane-to-grid projects for the balance of 2018 and into 2019 as a result of the recent passage of the RHI. Securing certifications and authorization for funds under the RHI, however, is progressing at a pace one would expect of a government program. The industry anticipates hundreds of projects under the RHI and we are seeing biomethane suppliers seeking first-mover advantage in this growing market come to us to secure Orbital-UK's integration services and access to GasPT units.

As an example, we recently received a third purchase order from a large industrial company and leading biomethane-to-grid supplier under a contract secured shortly before the passage of RHI. We currently have 27 bids out for biomethane projects and expect to have as many as 33 bids outstanding by the end of the year.

We are also seeing greater adoption of our VE Technology and sampling systems by existing customers. Subsequent to the close of the third quarter, we received a second purchase order from a multi-facility ethylene producer, a fourth purchase order from a leading North American petrochemical company and an order for probes from an existing Australian customer for supplemental mercury sensing systems. We expect to deliver all of these orders in the fourth quarter.

Looking farther ahead, the steps we've taken to seed the market with customers who could scale their orders as their confidence in our technology builds, puts us on a path to revenue ramp in 2019, driven by higher energy product sales supported by order flow for our ICE Technology.

Let me take a few minutes to detail the initiatives we are pursuing for growth in 2019. In our Energy segment, formalize and exclusive global distribution relationship with Samson AG has helped build market awareness and speed adoption of our GasPT solution. Samson sales footprint is aligned with gas transmission companies and operators globally, who are transitioning to lower carbon future.

Through Samson, we're putting GasPT in front of these operators at a time when they are moving to inject biogas into their existing natural gas networks. From our perspective, Samson's partnership with us is an acknowledgment of the much more favorable economics to operators CapEx budgets of our cost-efficient, fast, and highly accurate GasPT technology when compared to the expensive and slow gas chromatographs.

Our agreement precludes me from disclosing the number of annual unit sales required for Samson to maintain its exclusivity. However, we are optimistic about a meaningful order flow in 2019, given the time and effort we've put into getting Samson sales force up to speed. In fact, Samson is already in the marketplace in Europe with the GasPT and we've recently trained up Samson's sales group in China on our GasPTi.

The RHI will also continue to catalyze biomethane opportunities for us into 2019 with 40-plus new projects already on the drawing board beyond the 33 projects we expect to bid by year-end.

The certification process with Measurement Canada is ongoing and we have advanced the field trials with the Canadian pipeline operator. We expect both certification and initial deployments with that operator in 2019. I would also note that our pre-sales activity in North America has generated interest from 2 additional operators; both of these are in the earliest of stages.

Turning to our opportunity set for the GasPT for process control applications, we continue to progress certification of GasPT with a large turbine manufacturer and are working with them in parallel to plan a limited field trial deployment with one of their customers. Yesterday, we announced a significant partnership with Mitsubishi Electric Europe to create, produce, and sell our next generation IRIS system.

You may recall that IRIS is a unique proprietary telemetry software solution and Remote Telemetry Unit or RTU, developed by the Orbital to enhance the pipeline operator's ability to remotely monitor, manage, control, and troubleshoot risks procedures and difficulties that may arise at the site.

Our new VIRTU system builds on the dynamic user-friendly aspects of IRIS, but was developed with specific input from our largest network customers to further address their unique needs and requirements. We and Mitsubishi have developed an RTU solution that we believe will be very compelling to the market and we expect to introduce the first production units in January of 2019.

Touching briefly on Italy. Here's what we know about where the re-metering project stands today. A new Energy Authority was appointed and approved by the new government in September. The new authority is working through the regulatory backlog, of which the proviso that effectively restarts the re-metering project is one. In the interim, installation teams at both our distributor and the end customer remain in place and tasked to an eventual restart.

As a reminder, there are approximately 350 GasPT units in inventory with our customer that must be first to work through. Perhaps most important, the economics of the re-metering project favor a continuation of the project. There simply is no cost efficient alternative to our GasPT.

Finally, turning to our Power segment and specifically our ICE Technology. We continue to work towards a sizable emerging opportunity for this disruptive power optimization and utilization technology. We recently announced that SAP's Co-Innovation Lab or COIL has selected the ICE Technology for deployment in a field trial that, upon completion, would allow for deployment of the ICE Technology across SAP's 45 data centers worldwide.

We expect to install ICE Block at COIL by the end of this year. We continue to progress additional proof of concepts with other data center ecosystem participants to secure volume orders in 2019. We are also positioning ourselves for maximum benefit from the industry's growing awareness of Software-Defined Power or SDP as the missing piece that can alleviate power capacity pressures and optimize energy utilization within the data center.

And as SDP itself becomes integral to the development of hyper-converged power solutions, we recently made an investment through a convertible note in our partner VPS that gives us additional optionality on VPS's future success. In parallel, we are seeking additional ways of bolstering VPS' leadership position in SDP solutions, be it shared architect development and other initiatives that, again, enhance our optionality.

Beyond 2019, though with some revenue contribution expected in 2018, our involvement in the Future Billing Methodology project or FBM is our largest energy opportunity. We recently announced that monitoring station designed as part of Phase 1 of the FBM project are undergoing factory acceptance testing. As part of Phase 2, we expect to deploy approximately 44 stations throughout the U.K. to begin field trials and proof-of-concept of this unique approach to the way gas quality is measured.

These stations will operate for about 1 year after which the project will make a final determination before moving to Phase 3, which would entail the deployment of between 5,000 and 45,000 of the stations throughout the U.K. The FBM project requires that the devices be relatively inexpensive, efficient, and require no service gas. There is literally no competing technology that can do what our GasPT technology can do and meet all 3 criteria.

The GasPT recently secured certification from the European Union's Emissions Trading System or EU ETS through which the instrument has now been certified as the physical monitoring solution throughout the U.K. and Western Europe. With this certification, our GasPT solution for FBM can now be utilized for FBM like projects in other Western European countries.

As you conclude from my remarks this morning, we have developed a broad opportunity set across both of our 2 business segments that can positively contribute to both our top and bottom lines moving into 2019 and beyond. We also remain committed to opportunities to accelerate our progress through M&A and strategic partnerships that would enable us to profitably scale the company. Above all, the management team and I are resolute in our commitment to positioning the company, its disruptive technologies, and its market opportunity to maximum shareholder value. Thank you for your time and attention this morning.

Operator, please open the call to questions.

## QUESTION AND ANSWERS

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- Operator - -

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

- **Eric Andrew Stine – Craig-Hallum** - Senior Research Analyst in the Equity Research department

  Q. Just wondering, if we could start with the biomethane opportunity, you mentioned there could be hundreds of units there, just wondering what the competitive environment is and thoughts on how those hundreds of units roll out and what your win rate maybe?

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

A. Yes, hi Eric, how're you doing? It's Bill. The issue of hundreds of units is exactly that. They want to, in essence, go to 20% of biomethane fuel providing energy by 2022, and that literally would be, Oh, I think over 2000 units, if they actually go to 20% and so that would be obviously a large rollout. As far as the competitive landscape, there are a number of entities who are coming into it. It's obviously a big project. They [each of the units] are about £0.5 million~~[GBP 0.5 million]~~. So, somewhere approaching USD $600,000, $700,000 a piece for these units. The key though is really the GasPT that's the differentiator. Everyone else has to use a gas chromatograph. It's about again 3x to 4x as expensive, plus more important than anything else, it's very complicated and requires maintenance, which none of these systems want because obviously they're being placed in farming consortiums and other areas where you don't have a lot of sophisticated operators. So we have a leg up there. To-date there have been 8 bids awarded under the new RHI scheme. We have won 6 of those~~,~~ 8 which is a pretty good hit rate. We currently have 27 bids outstanding. As I mentioned, we expect to have as many as 33 outstanding by the end of the year. We feel quite confident that we're going to get 50% to 60% of those, simply because of our competitive advantage with the GasPT. I will tell you that Siemens has come into the market in a big way. They have approached us about including the GasPT in their systems as well. We will probably allow that to happen, obviously with nice margin involved. But to-date really we're finding great acceptance of the GasPT. In fact Ofgem specifically approved the GasPT for the Gas-to-Grid skids that we're creating and it really has given us a great competitive advantage. So again, I think we could look forward to getting 50% to 60% of those bids, maybe even more. And to-date we have gotten 6 of the first 8 of the bids that were awarded.

- **Eric Andrew Stine – Craig-Hallum** - Senior Research Analyst in the Equity Research department

  Q. And then maybe, you mentioned a second order for ethylene, I guess I was under and may be mistaken, but under the understanding that you had already received a second. So are you saying that this as a follow-on order and that the first 2 orders had been from different energy companies or did I just misunderstand that you had that second, that follow-on ethylene order for the probe?

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

  A. Yes, this is a different operator. This is a different operator.

- **Eric Andrew Stine – Craig-Hallum** - Senior Research Analyst in the Equity Research department

  Q. And then maybe last one from me, just talking about ICE Block and SAP and the COIL lab, I mean, is it fair to think of that, I mean $2 million to $3 million per site. And then, you mentioned 45 data centers and the potential to roll it out across that footprint, should things progress. As far as the other companies that you are working with, I mean how do you view the opportunity? Would you say that SAP is on the high-end or the other opportunity is potentially larger?

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

A. Hey Eric, this is Dan. Based on what we know right now of our opportunity set, the pricing for that project is, you're correct, in that \$2 million to \$3 million per data center neighborhood is what it looks like right now. SAP obviously has good sized datacenter at those 45 facilities, so that's why it's at the higher spectrum of those projects from a revenue standpoint. In regards to the opportunity set, I would say SAP is the nearest to going to revenue from a large scale opportunity, but we're working with one customer that has more than 150 locations of good size data centers, more of a co-location type of company. So there is a whole range of it. Most of the companies that we're in front of right now do have multiple data centers, SAP being one of the larger ones but not the largest. They are definitely the furthest advanced in the testing protocols that they're doing from having been in the labs, their research type labs now and going into the COIL lab, which is more of a live data center type of environment for proving it out in that type of environment facility with them, and sort of the last step before they look to putting it into how they're going to roll it out in the program. So, so far so good on that front with SAP and with others and we're continuing to see progress, we're continuing to see inquiries, working closely with VPS on all fronts with that technology and we're confident it's progressing how it should be. And that's a big reason why we put \$500,000 into VPS in a convertible note, which we'll see is converting to equity investment and in the long-term, which allows us to have a play on some of the opportunities with them from the software side as an investor, and not just participating on the hardware side, because they are working on some other uses for that technology beyond the ICE Switch and Blocks that we want to be able to participate with, but not something that we'll be building. So, we see great opportunity with VPS and with ICE and SAP. Again, we do expect them [SAP] to continue to progress. And with 2019 being the opportunity for that, we expect that to turn to revenue sometime mid-year probably is when we'll see some volume projects turn.

- **Eric Andrew Stine – Craig-Hallum** - Senior Research Analyst in the Equity Research department

  Q. Got it, with SAP and then I mean with other companies, I mean fair to say that we could see some announcements or just things that might point to the future with those customers in 2019?

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

  A. Yes, that's the goal. Of course, a lot of these companies don't allow their names to be made public, but when they do, we are going to endeavor to do so.

- Operator - -

  A. Our next question comes from Rob Brown with Lake Street Capital.

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

  Q. On the COIL project, how long is the evaluation period there? And sort of what's the process these guys use to roll out a project after a positive outcome?

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

A. Yes, they don't really share that information with us. We can say that historically most of their field test like this lasts 3 to 6 months. But again, that's something that really, they're going to determine as the test rolls out. I mean they have certain criteria that they have to meet and that's internal to them and frankly I think they don't share with us particularly because they want to make sure we address what they need. So again, I would say somewhere between 3 and 6 months.

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

Q. And on the economics for the customer, if it's $2million to $3 million a data center, what's sort of their ROI and return period that you guys are seeing?

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

A. So the ROI depends on a number of factors, one is their cost of how much power is costing them at a rate standpoint, but the ROI in summarily for most of our customer opportunities is, if it's a greenfield application, which this one they'd be saving somewhere in the neighborhood of 40% to 60% on CapEx by reducing the amount of power they need to bring into the facility from power generation, excess power panels and then also air conditioning, cooling and fans and floor space frankly. In an existing facility, the savings is going to be if you're replacing the equipment already as well as from an operating standpoint. So there is the reduction in power cost which is operating costs -- is looking at more of a 20% to 25% reduction in operating costs. So you're going to be more efficient by that amount which is going to reduce your power consumption, power being the less expensive ongoing cost for data center. And then, more importantly or just as importantly, you're able to operate at a higher level during peak demand times. So they're going to be going from 80% to 85% operational to approaching the 95% target of being operating during a peak demand time, which means more revenue to them if their data center is being hammered because of election night and everybody is checking what's going on. They've got to keep those data racks up and running and this allows them to have the power capacity to do so without either paying increased power consumption charges, which impacts the power cost or, frankly, without going down because they don't have enough capacity to service that need. And that's the real benefit of this device is it's not just a cost reduction from an operating cost standpoint, but it's also their ability to serve their customer and generate greater revenue opportunity set through that. So it's a multi-faceted approach and it'll be case by case. That's part of the sale, frankly, that we work with the customers is, okay, we can analyze their information with VPS, see what they're spending on power, see how they're doing things and then come to them with a solution that shows them what the benefits of our device would be. But part of that is based on their data, if they want to take that approach to it. A company like SAP is looking at it more analytically across their entire organization, I think with the COIL lab information. They're doing that analysis of the benefits that they're seeing from that location on their own. But the ROI is individually each data center frankly but broadly it's going to be based on, you're reducing your operating cost by 25% or so and then if you're doing a greenfield operation, your ROI is immediate because you're reducing what you're spending on your CapEx for the build out.

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

Q. And then last question on Samson and some of the international development started and in particular China, what sort of the opportunities you see there and how long does it take to ramp that? I know it's a tough question to answer, but Samson since has accelerated that, but what's sort of the China picture look like at this point.

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

A. Yes, I can't give you many details other than; I did talk to the team that's in Beijing. They just finished training last week. They're now going to Shanghai for customer contact. So I know they're moving quite rapidly. The good news in that market is, it is obviously a very strict regulatory environment where one entity, the Chinese Government, controls everything that happens and if the Chinese government likes what you produce, then there is no regulatory requirements, you simply move into the marketplace. So I think, from that perspective, with the history we've had with certification in Europe and the time it took there and some of the other issues we've had in North America that is going to be much simpler, I think much quicker move into the marketplace. In fact, other technologies, particularly in natural gas have moved into China quite quickly because China is hugely dependent on natural gas. They've increased and expect to increase their both importation and production dramatically over the next few years. I think I quoted some facts in the press release that we made that they're going to be producing some 362 billion cubic meters of gas on an annual basis, with their importation approaching 92 million cubic meters. So they're going to have a lot of gas out there. They are very, very interested in granular metering. For example, they are now using, more than any other nation in the world, natural gas to power vehicles and we've already had inquiries about the fact that they realized that gas is not gas is not gas. They understand the gas being put into their vehicles at the pump are of different quality and to-date there's been nothing available to measure that quality at the gas pump. We obviously provide them with that ability because of the cheap nature and the low maintenance of our device. So we're quite excited about it. We think it's a huge opportunity. I can give you very little detail as to how fast it will move though, I think I will know though, in the next few weeks, simply because now the Samson sales group and their manufacturing unit there have been fully trained and are eager to get out to the marketplace. As I mentioned, we finished the training last week and we're already in Shanghai doing customer meetings. So, we think that their push is going to be quite dramatic and I'll be able to tell you, certainly next quarter, what results we're starting to see.

- Operator - -

A. (Operator Instructions) Our next question comes from Edward Stacey with Capital Network.

- **Edward John Stacey - Proactive Investor UK Limited** - Research Analyst

Q. First question is about cash and CapEx because you've talked about wanting to sort of manage that cash position carefully. I just wondered, particularly with GasPT ramp up in 2019, if the Italians suddenly start moving the project ahead with Snam Rete or if Samson suddenly start turning up a lot of orders. Is there any risk for yourselves of a CapEx shock in some way in order to be able to support that revenue?

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

A. No, no. The brief answer is no. And the reason is simply this; we have almost 300 units in inventory, obviously, preparing for a restart on the re-metering in Italy. However, if China or someone else ramped up, obviously those 300 units would go where they needed to go. Secondly, we have the ability to ramp up to a 100, 150 units or more production in a month, if we needed to, and with very, very little additional CapEx because we've done most that build out, we have the people involved, we have the calibration units in place. And then, we've talked about this in the past, we have a really great banking relationship with the Wells Fargo Bank, and if we did begin getting purchase orders of a sizable nature from Snam Rete or other like-sized utility companies, they would fund those, based on those purchase orders very quickly. So we feel quite confident that if we got an order like that, or I should say when we get an order like that, we'll be well able to service it.

- **Edward John Stacey - Proactive Investor UK Limited** - Research Analyst

  Q. And then just one other also on GasPT, the fair billing methodology, you mentioned the Phase 3 stage of that is where we would certainly move to looking at thousands of stations being built. Do you know if the regulators have any target date now for actually entering into Phase 3?

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

  A. Yeah, the push has always been and it's maintained at this level, till the late 2019 with deployments beginning in 2020. So that's always been the date, it's still in place. That's one of the reasons that the push is on to get these monitoring stations out, because obviously during the course of the roughly 12 month field trial, they're going to be making those assessments and at the end of that field trial, expect to be making a decision and moving forward on the project. There is funding available for it. It's a big issue in the U.K. because of the push for biomethane gas and the fact that that biomethane gas without the [future] billing methodology is really no cleaner than normal natural gas. The only way to put biomethane into the grid and do it in a method that is, in fact, environmentally friendly is to stop enhancing it, stop injecting propane into it, and to do that they're going to have to move billing downstream from those stations and that's future billing methodology. So again, I think that the target date has always been late 2019, and I still see that as the date that we'll find out which way they choose to go. And there is basically 3 levels they've designated; one would be the minimum, which is around 5,000 units and in the most would be the ideal system, which is the one we're obviously hoping and pushing for, and that would be as many as 45,000 units across the entire nation. So, again, that's where that project lies.

- **Edward John Stacey - Proactive Investor UK Limited - Research Analyst**

  Q. Thank you.

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

  A. Ed, this is Dan. I just wanted to touch on your first question also regarding having the capacity to meet Snam Rete, if they were to move quickly on high volumes. We know that it won't be a quick movement in the sense of, we don't expect them to request 500 units at a time overnight. We expect them to be requesting hundreds of units, some 50 to hundreds of units a month and that will be a ramp. So we know that we have the capacity to grow into that as they grow into their installation program with that. But right now, we have the inventory on hand to service that, and then we also -- just to touch on cash and turnover on that is, we have built up inventory to meet that demand. We built up inventory across the organization to support our customers right now both with tariffs being put in place by the U.S. government on goods, especially of our Power group. But when it comes to payment terms on the GasPT projects with Italy, we generally are seeing the cash payments within 60 days on that project. So in short order, it would turn from inventory back into cash to support the ongoing requirements of servicing that customer and others. So we don't see a pinch point with regards to Snam Rete on starting back up, we actually see that as a very positive from a cash flow standpoint and operating asset standpoint.

- Operator - -

  (Operator Instructions) Our next question comes from Jeff Bernstein with Cowen.

- **Jeff Bernstein - Cowen**

  A. Yeah, I had a couple of questions. Just, can you talk a little bit more about North America and your progress and what you think the role for GasPT is here? Obviously, there's a huge amount going on with dairy farms and I think Smithfield Foods alone is going to do over 30 projects. Can you guys address this market, and when do you think that will happen?

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

  A. Yeah, because of our certification and our experience in Europe, we are pushing into that marketplace. We have contacts already moving into that and talking to people. We think that there's going to be great deal of opportunity, particularly in Canada, where this is a very popular method of alternative energy. Less so in the U.S. at this point, simply because the projects are not really developing there, but I think Canada is becoming a much more of an attractive place for us to be. We are, in fact, working with a large utility company up there as we've mentioned in the past. We think that that will result in a large order. We expect that to occur in 2019. And then, on the process front, we have a big electric producer utility in the Midwest. It's about to rollout several of our GasPTs as process control devices for turbines, that's a field trial that's in cooperation with a large turbine manufacturer we're working with. And so, we think that, again as 2019 progresses, we'll see more and more penetration into the market in North America. Again, it will be largely process control, and we think metering in Canada and obviously some used in biomethane as that market develops.

- **Jeff Bernstein - Cowen**

  A. And just to follow up on the turbine piece. Am I wrong that you already have the ability to sell into the aftermarket? Or is this still, we're still waiting for approval on that? And then what about the ability to have an OEM type product?

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

A. Yeah, the aftermarket is still difficult, because we need the certification [from the OEM] which we're seeking to confirm that we don't affect the warranty issues. That's always a problem with the aftermarket. We have a number of aftermarkets, frankly customers who would take our device tomorrow. But the problem is, until we have certification, it would negatively impact the warranty and the warranties on those big machines obviously are critical. You're talking about tens of millions of dollars and you are talking about warranties that cover damage in all sorts of nature, and you just simply can't put anything on that machine and keep that warranty active until it's certified. So that's the key and that's what we're pushing for.

- **Jeff Bernstein - Cowen**

A. Got you. Understood, for some reason I thought you had already gotten that. Thanks.

- Operator - -

Ladies and gentlemen, thank you for participating in the question-and-answer portion of today's call. I would now like to turn the call back over to management for any closing remarks.

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

A. Again, I'd just like to thank everybody for their interest and points to the fact that we have spoken about this year being a transitional year for us. We have talked a lot about the second half of the year being much stronger than the first half. We think that that has been demonstrated by our third quarter and will continue into fourth quarter. With that being said, I think you and I look forward to talking you either individually or next quarter call. Thank you.

- Operator - -

A. Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect and have a wonderful day.