CUI Global, Inc.
Form 10-K
March 14, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-K**

x ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from_____to_____

Commission File Number 0-29923

**CUI Global, Inc.**

(Exact name of registrant as specified in its charter)

| | | |
|---|---|---|
| Colorado | (3670) | 84-1463284 |
| (State or jurisdiction of | (Primary Standard Industrial | (I.R.S. Employer |

incorporation or organization) Classification Code Number) Identification No.)

20050 SW 112 th Avenue

Tualatin, Oregon 97062

(503) 612-2300

(Address and Telephone Number of Principal Executive Offices and Principal Place of Business)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange where registered |
|---|---|
| Common Stock par value $0.001 per share | The NASDAQ Stock Market |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ¨ Yes x No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ¨ Yes x No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of ''large accelerated filer,'' ''accelerated filer'' and ''smaller reporting company'' in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). ¨ Yes x No

The aggregate market value of the voting and non-voting common equity held by non-affiliates, based on the closing price of our common stock on the last business day of the registrant's most recently completed fiscal second quarter (June 30, 2015), was approximately $71,589,371. Shares of common stock beneficially held by each executive officer and director as well as 5% holders as of June 30, 2015 have been excluded from this computation because these persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

As of March 11, 2016, the registrant had 20,878,883 shares of common stock outstanding and no shares of Preferred Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

# PART I

## Item 1. Business

### Corporate Overview and Our Products

CUI Global, Inc. (‘‘CUI Global’’ or “The Company”) is a Colorado corporation organized on April 21, 1998. The Company’s principal place of business is located at 20050 SW 112th Avenue, Tualatin, Oregon 97062, phone (503) 612-2300. CUI Global is a platform company dedicated to maximizing shareholder value through the acquisition, development and commercialization of new, innovative technologies. The Company's operations fall into two reportable segments: Power and Electromechanical segment and Energy Segment. In addition, the Company’s corporate overhead activities are included in an ‘‘other’’ category. The Company has subsidiaries in 4 countries, including the United States. Through its subsidiaries, CUI Global has built a diversified portfolio of industry leading technologies that touch many markets.

### <u>Power and Electromechanical Segment</u>

**CUI, Inc., CUI Japan, and CUI-Canada - Subsidiaries**

CUI, Inc., is based in Tualatin, Oregon, CUI Japan is based in Tokyo, Japan and CUI-Canada, acquired in March 2015, is based in Toronto, Canada (collectively referred to as “CUI”). These three subsidiaries are providers of electronic components including power supplies, transformers, converters, connectors and industrial controls for Original Equipment Manufacturers (OEMs). Since its inception in 1989, CUI has been delivering quality products, extensive application solutions and superior personal service. CUI's solid customer commitment and honest corporate message are a hallmark in the industry.

The Power and Electromechanical Segment aggregates its product offerings into two categories: components including connectors, speakers, buzzers, test and measurement devices, and control solutions including encoders and sensors; and power solutions, which includes among other power products, the Novum Digital Power Modules. These offerings provide a technology architecture that addresses power and related accessories to industries as broadly ranging as telecommunications, consumer electronics, medical and defense.

***<u>Power Supply Units</u>***

Our current power line consists of external and embedded ac-dc power supplies, dc-dc converters and basic digital point of load modules. This dynamic, broadly applicable product line accounts for a significant portion of our current revenue and recent revenue growth.

*Digital Power Patent License Agreement with Power-One, Inc*.

The company entered into a non-exclusive Field of Use Agreement with Power-One, Inc. to license Power-One's Digital Power Technology patents. The license provides access to Power-One's portfolio of Digital Power Technology patents for incorporation into the company's line of digital point of load power modules. The company, through its power division, also manufactures a wide range of embedded and external power electronics devices for OEM manufacturers.

*Advanced Power*

With the rapid rise in cloud computing and the “Internet of Things,” CUI is well positioned with our advanced power portfolio to address these quickly-growing markets. System complexity, energy efficiency regulations and the need for more processing power in smaller spaces has moved digital power to a mandatory technology in datacom, server and storage applications. As one of the early adopters of digital power, CUI continues to be an industry leader in this space. With the recent release of the NDM3Z 90A POL module, CUI set a benchmark for power output in a point-of-load (POL) module, addressing the needs of the most advanced ICs on the market. As a founding member of the Architects of Modern Power (AMP) Group® power consortium partnered with Ericsson Power Modules and Murata, CUI is driving change in the industry to ensure supply chain security and push technology innovation for tomorrow’s applications. The acquisition of certain assets of Tectrol, Inc. (now CUI Canada) in 2015 now allows us to address the front-end power requirements of these same systems, providing a complete power solution for our customers. In an environment where OEMs are working to reduce their approved vendor list, the capability to deliver a full system solution is becoming critical.

During 2014, CUI, Ericsson Power Modules and Murata announced the formation of the Architects of Modern Power (AMP) consortium. The goal of the AMP alliance is to realize the most technically advanced, end-to-end solutions and provide a complete ecosystem of hardware, software and support. Beyond purely mechanical specifications, it is the standardization of monitoring, control and communications functions, and the creation of common configuration files for plug-and-play interoperability that will ensure compatibility between each firms’ products.

As the large scale networking and telecommunications companies convert to digital power, our early entry into the market, and our relationship with Ericsson should enhance our ability to penetrate this (according to the Darnell Group) multi-billion dollar market.

**Components**

AMT ® Encoder

The company has an exclusive agreement to develop, sell and distribute the AMT encoder worldwide. The AMT series modular encoder is designed with proprietary, capacitive, code-generating technology as opposed to optical or magnetic encoding. This unique device allows breakthroughs in selectable resolution, shaft-adaptation and convenient mounting solutions to bring ease of installation, reduction in SKU’s and economies of scale in purchasing. The AMT amounts to almost 2000 different encoders in one package. The company is selling and distributing the AMT through various customers. Moreover, the product is being marketed by multiple DC motor manufacturers. The AMT has been awarded several design wins from Motion Control OEM’s producing a wide range of products from cash machines to robotics.

***ISO 9001:2008 Certification***

CUI, Inc. is certified to the ISO 9001:2008 Quality Management Systems standards and guidelines. CUI is registered as conforming to the requirements of standard: ISO 9001:2008, The Quality Management System is applicable to Design, Development and Distribution of electro- mechanical components for OEM manufacturing. ISO 9001 is accepted worldwide as the inclusive international standard that defines quality.

The certification of compliance with ISO 9001:2008 recognizes that our policies, practices and procedures ensure consistent quality in the design services, technology and products we provide our customers.

**Energy Segment**

**Orbital Gas Systems, Ltd. and Orbital Gas Systems, North America, Inc. - Subsidiaries**

Effective April 1, 2013, CUI Global closed on a share purchase agreement to acquire 100% of the equity interest in Orbital Gas Systems Limited, a company organized under the laws of England and Wales (‘‘Orbital’’), from Orbital’s sole shareholder. In 2015, the Company started up a North America subsidiary to its Orbital business.

Orbital is the largest natural gas systems integrator in the U.K. and has operated successfully in the natural gas industry for over 25 years. In addition, Orbital is a leading provider of natural gas infrastructure and high-tech solutions to National Grid, the national gas transmission company in the U.K. and one of the most respected specialized gas engineering companies in the world. Orbital has developed its portfolio of products, services and resources to offer a diverse range of personalized gas engineering solutions to the gas utilities, power generation, emissions, manufacturing and automotive industries. Moreover, its proprietary VE® Technology enhances the capability and speed of our GasPT® Technology.

GasPT®

Through an exclusive licensing contract with DNV-GL (formerly: GL Industrial Services UK, Ltd.) (formerly: British-based Advantica, Ltd.)(‘‘GL’’), CUI Global owns exclusive rights to manufacture, sell and distribute a Gas Quality Inferential Measurement Device (GasPT) designed by GL on a worldwide basis, now marketed as the GasPT. The Company has minimum commitments under this licensing contract.

The natural gas inferential metering device, the GasPT, is a low cost solution to measuring natural gas quality. It can be connected to a natural gas system to provide a fast, accurate, close to real time measurement of the physical properties, such as thermal conductivity, speed of sound and carbon dioxide content. From these measurements it infers an effective gas mixture comprising four components: methane, propane, nitrogen, and measured carbon dioxide and then uses ISO6976 to calculate the gas quality characteristics of calorific value (CV), Wobbe index (WI), relative density (RD), and compression factor (Z). An ISO, International Organization for Standardization, is a documented agreement containing technical specifications or other precise criteria to be used consistently as rules, guidelines or definitions of characteristics to ensure that materials, products, processes and services are fit for their purpose.

This new and innovative technology has been certified for use in fiscal monitoring by Ofgem in the United Kingdom, the Polish Oil & Gas Company Department of Testing and Calibration in Warsaw, NOVA Chemical/TransCanada in Canada, the Pipeline Research Counsel International (PRCI) in the US and NMi & The International Organization of Legal Metrology (‘‘OIML’’) for SNAM RETE in Italy. At present, there is no equivalent product competition. There are instruments like gas chromatographs (‘‘GC’’), but they are slow, complicated to use and as much as five times the price of the GasPT.

By way of example, in the case of SNAM RETE, the Italian gas transmission company, there are 13 natural gas injection points for the SNAM RETE system. Those injection points will continue to use GC’s for monitoring. On the other hand, there are 2,500 customer access points, servicing 7,500 customers. Those would include city gates, large industrial users, power generation plants and others. All of those customer access ports would be applicable for the GasPT Technology.

In addition, there are currently 50,000 gas-fired turbines in operation worldwide. Each of those turbines is subject to variances in natural gas quality. Depending on the quality of the gas, by using our GasPTi Technology, those very expensive machines can be tuned to run more efficiently and therefore longer with much cleaner emissions. Currently, because of the delay in information from the GC's, such tuning cannot be effectively accomplished. It is this greater efficiency that has lead National Grid in the UK to change its entire turbine control strategy, cancelling orders for several GC's and, in October 2013, replacing those GC's with an order for eight (8) GasPTi devices specifically designed for natural gas-fired turbine control.

In conjunction with the Orbital acquisition, we have moved the entire GasPT technology portfolio, along with the VE-Probe, into Orbital's product division, Orbital Global Solutions (Orbital-GS). Orbital-GS has successfully introduced the combined GasPT unit and VE-Probe to National Grid, the largest natural gas provider in the UK. In addition, along with passing first phase testing by GE-Energy in October/November 2012, the GasPTi device successfully completed second phase testing with GE-Energy in October 2013.

In January 2012 the company entered into a five-year, exclusive distribution agreement for our GasPT technology with an Italian company, SOCRATE s.p.a. for sales, marketing, distribution and service of our GasPT gas metering device for Italy and North Africa, including Libya and Tunisia. SOCRATE is the ‘‘vendor-of-choice’’ for SNAM RETE GAS (‘‘SRG’’) and was referred to the company by SRG. SOCRATE continues to be involved in negotiations with SRG relative to both the 2010 Technical Upgrade of Metering Facilities and 2011/2012 New Capacity and Implementation Plan. In conjunction with those two initiatives, SRG transmission system has concluded 24 months of in-field testing with six (6) GasPTi units.

On September 3, 2015, SRG issued a public tender for the installation of a minimum of 3,300 metering devices to change the way SRG monitors its facilities and assets. After a several month bidding process, Orbital and its partner, SOCRATE were awarded the initial purchase order (400 units) pursuant to the tender.

Following the acquisition of Orbital and the transfer of gas operations to Orbital-GS, the company has entered into a series of 42 Distribution Agreements with internationally recognized entities in the natural gas industry. These agreements are designed to supplement and enhance our previously announced and continuing agreements with BENCHMARK, IVES EQUIPMENT, SOCRATE and others.

*VE-Probe and* VE *Technology*

On July 30, 2013 our Orbital subsidiary acquired exclusive worldwide rights to manufacture, sell, design, and otherwise market the VE-Probe and VE *Technology* from its United Kingdom-based inventor, EnDet Ltd. The agreement gives Orbital exclusive and sole control of all technology related to its revolutionary GasPT and GasPTi natural gas metering systems. The GasPT technology provides fast and accurate measurement of the physical properties of the natural gas mixture. By combining the GasPT technology with the equally unique VE-Probe, which is able to provide a gas sample from a high pressure transmission line in less than two seconds, Orbital has created the GasPTi metering system.

The GasPTi system is able to accurately provide almost real-time data to the natural gas operator in a total cycle-time of less than five seconds. Moreover, it provides this real-time analysis at approximately one-fifth of the installation cost of current technology with none of the associated maintenance, carrier gas, calibration gas, or other ancillary costs associated with traditional technology.

This VE *Technology* acquisition gives us the ability to control and produce the entire Bill of Materials for our GasPTi systems, thus allowing us to capture a far larger margin as we provide this unique metering solution to the natural gas industry. Additionally, we can now also manufacture, market and sell additional applications for the VE *Technology*, including sampling systems separate from the GasPT and Thermowells found throughout all pipeline systems.

In addition, the VE *Technology*, in combination with applicable detectors, allows us to produce trace-element detectors for such components as mercury (Hg), moisture (H 0), and hydrogen sulfide (H S) that are particularly effective in quickly and accurately identifying these elements. That ability has allowed us to sell a significant number of our probes into the Gorgon LNG Project in Australia, a large Northeastern LNG terminal in the US, and chemical plants throughout North America.

**Anticipated Growth Strategy for Our Electromechanical Product Line**

We hope to grow our electromechanical product line through a planned strategy to increase our name recognition as a technology company. Our plan, already in effect, includes:

- Developing collaborative relationships with our customers by seeking to meet their design needs in a timely and cost effective manner.
- Developing new technologies and expanded manufacturing capabilities as needed.
- Growing our global sales and distribution through our primary international distribution channel, a prominent international sales and distribution strategic partner that ships product to more than 170 countries worldwide from a single location in the United States.
- Directing our marketing efforts through one of our two channels, either directly with the sales representative who understands the targets in the area or through our distributor with partnership marketing.
- Attending strategic trade shows to grow our brand presence for our proprietary products. Because of our growing recognition in innovation, we need to be where the heads of the industries are, particularly at industry trade shows.

These areas, however, need forward-looking growth investment to understand the customers' needs and develop products accordingly. We are in line with market standards for quality, customer service and pricing. Our plan is to stay with this mark during our anticipated growth. We intend to expand according to our existing model. The expansion means more manufacturer representative coverage and outside sales people in strategic areas throughout the United States. We intend to eventually have field application engineers in the strategic areas driving designs at the customers' facility.

**Anticipated Growth Strategy for GasPT®**

We are presently in the midst of our marketing efforts for our GasPT Inferential Natural Gas Monitoring Device. Our strategy for GasPT has been to identify the large gas utility companies who would most likely provide opportunities for batch sales rather than single unit sales. Our 'sale or return' sales approach has been accepted very positively in Europe and the United States. For the past three years, this approach focused strongly on the United Kingdom, Europe and the United States and the Company will continue its efforts in those areas as well as begin the process in the Asian markets, with India identified as the test market. Beyond this, our strategy is based on identification of the main geographical locations for liquefied natural gas importation (pipelines and terminals), mixing and blending points and strategic locations for security of supply strategies, which can be current or planned pipelines and import terminals where additional gas quality monitoring may be required.

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Additionally, our wholly owned subsidiary, Orbital Gas Systems, Ltd., the largest specialty gas engineering company in England, introduced the combined GasPT unit and V-Probe to National Grid, the largest gas transmission/distribution company in the UK. We entered into a second five-year, exclusive distribution agreement for our GasPT technology with an Italian company, SOCRATE s.p.a., for sales, marketing, distribution and service of our GasPT gas metering device for Italy and North Africa, including Libya and Tunisia.

According to the latest industry analysts (including *MarketsandMarkets*), the global GC market reached $2,583.6 million in 2014 and is poised to grow at a CAGR of 6.9% from 2014 to 2019, reaching $3,605.1 million by 2019. Admittedly, that market is mature and is dominated by ‘‘aftermarket and accessories’’ sales. In contrast, the GasPT Technology is less expensive, more efficient and dramatically faster than any available GC. It provides almost real-time monitoring without the need for a large enclosure, carrier gas and, most significantly, regular technical support and calibration. Taking all of those factors into account, it is our intention that the GasPT Technology will rapidly and effectively penetrate a large segment of that $2.5+ billion market.

**Acquisition Strategy:**

We are constantly alert to potential acquisition targets, both in the form of innovative technology and potential strategic partners. In that regard, we are repeatedly approached by inventors and others, most especially in the power industry, to assess and assist in commercialization and marketing of new technologies. These contacts largely arise because of our reputation and successes as well as our recent technology product line additions including GasPT, and Novum. Moreover, much like when we acquired CUI, Inc., there are many small, well-run electronics companies that become available for multiple reasons. We will consider each of these potential opportunities as they arise with a careful analysis of the relevant synergies with our current business, along with the potential for increasing revenue and/or market share.

**Research and Development Activities**

Research and development costs for CUI Global were approximately $1.8 million, $1.3 million and $0.9 million for the years ended December 31, 2015, 2014 and 2013, respectively. Research and development costs are related to the various technologies for which CUI Global has acquired licensing rights or is developing internally. The expenditures for research and development have been directed primarily towards the further development of Novum Advanced Power technologies including digital POLs, AMT Capacitive Encoders and towards the development of the GasPT and VE Probe technologies. The Company expects that research and development expenses will continue during 2016 as the Company continues to expand its product offering and technologies due to market acceptance and customer integration.

**Employees**

As of December 31, 2015, the Company, together with its consolidated subsidiaries, had 352 employees. As of December 31, 2015, 78 of its employees in Canada are represented by a labor union. The increase in the number of employees compared to the 200 reported as of December 31, 2014 is primarily a result of the 2015 CUI Canada acquisition and the 2015 startup of Orbital Gas Systems Ltd., North America. The Company considers its relations with its employees to be good. The Company plans to add additional staff as needed to handle all phases of its business.

**Intellectual Property License Evolution**

*AMT ® encoder technology*:

Upon the acquisition of CUI, Inc., the Company obtained the relationship with the holder of the AMT encoder technology. Through an exclusive licensing contract with AnderMotion Technologies, LLC, signed on or about April 20, 2009, CUI acquired exclusive rights to manufacture, sell and distribute motion control devices utilizing the AMT encoder technology.

*Novum ® Digital POL technology*

Through a non-exclusive licensing agreement with Power-One, Inc., signed on or about September 18, 2009, CUI has access to Power-One's portfolio of Digital Power Technology patents for incorporation into CUI's new line of digital point of load (POL) power modules.

*GasPT® technology*

Through an exclusive licensing contract with GL Industrial Services UK, Ltd. (GL), formerly British-based Advantica, Ltd., signed on or about January 4, 2010, CUI Global acquired exclusive rights to manufacture, sell and distribute a Gas Quality Inferential Measurement Device (GasPT) designed by GL on a worldwide basis.

*VE-Probe and* VE *Technology*

On July 30, 2013 our Orbital subsidiary acquired exclusive worldwide rights to manufacture, sell, design, and otherwise market the VE-Probe and VE *Technology* from its United Kingdom-based inventor, EnDet Ltd. The agreement gives Orbital exclusive and sole control of all technology related to its GasPT and GasPTi natural gas metering systems.

**Intellectual Property Protection**

The Company relies on various intellectual property laws and contractual restrictions to protect its proprietary rights in products, logos and services. These include confidentiality, invention assignment and nondisclosure agreements with employees, contractors, suppliers and strategic partners. The confidentiality and nondisclosure agreements with employees, contractors and suppliers are in perpetuity or for a sufficient length of time so as to not threaten exposure of proprietary information.

Under the United States Trademark Act of 1946, as amended, and the system of international registration of trademarks governed by international treaties, the Madrid Agreement Concerning the International Registration of Marks and the Protocol Relating to the Madrid Agreement, administered by the World Intellectual Property Organization, which maintains the International Register, and, in several instances, direct trademark registration in foreign countries, we actively maintain up to date the following trademarks: CUI INC, CUI Europe, V-Infinity, AMT, Novum, CUI Global, Simple Digital, GasPT, IRIS, Vergence and Orbital Gas Systems.

The Company continuously reviews and updates the existing intellectual property filings and files new documentation both nationally and internationally (Patent Cooperation Treaty) in a continuing effort to maintain up to date protection of its intellectual property.

For those intellectual property applications pending, there is no assurance that the registrations will be granted. Furthermore, the Company is exposed to the risk that other parties may claim the Company infringes their existing patent and trademark rights, which could result in the Company's inability to develop and market its products unless the Company enters into licensing agreements with the technology owner or could force the Company to engage in costly and potentially protracted litigation.

**Competitive Business Conditions**

The industries in which the company competes are very broad. We operate a commoditized electromechanical parts distribution business that is focused on efficiency of delivery and competitive pricing to differentiate our products from competitors. The market is subject to some volatility due to production requirements of larger global firms. We feel that our electromechanical parts distribution business is diverse and broad. We have a very strong retail distribution partner that maximizes our product exposure to new designs and small to medium sized customers. We focus on the OEM market and supply higher levels of support, customer service and a constantly expanding product line, in order to further differentiate with our competitors. This product line ranges from a $0.02 connector to a $700 encoder – all different products for different customers. Additionally, we utilize third party external sales representative organizations to penetrate new and better customers otherwise not readily available to the company.

CUI is becoming more recognized in the power supply market and has differentiated itself through technology with a foundation of legacy and product quality. As of December 31, 2015, our power and electromechanical segment accounted for approximately 67.5% of our revenues and our Energy segment accounted for approximately 32.5% of our revenues. We have added new products and technologies that will provide us the opportunity to compete outside of price and more on innovative technology and strategic partnerships.

From our portfolio of full-featured digital point-of-load dc-dc converters, to our line of Platinum-rated front-end power supplies, we believe that we are ahead of the market leaders in our space and that the market is ready for new technologies and new ideas. With the shift toward digitally-based power supplies accelerating, our strategy is to develop a true software defined power ecosystem where the sum of the components is greater than its parts.

Similarly, the natural gas inferential metering device, the GasPT along with our VE-Probe, competes in a mature industry with established competitors. There are significant investments being made globally into the natural gas extraction and transportation infrastructure. Our natural gas quality measurement system is a comparably low cost solution to measuring natural gas quality as compared to our best competition. It can be connected to a natural gas system to provide a fast, accurate, close to real time measurement of the physical properties, such as thermal conductivity, speed of sound and carbon dioxide content. From these measurements it infers an effective gas mixture comprising four components: methane, propane, nitrogen and measured carbon dioxide and then uses ISO6976 to calculate the gas quality characteristics of calorific value (CV), Wobbe index (WI), relative density (RD) and compression factor (Z). This technology has been certified for use in fiscal monitoring by Ofgem in the United Kingdom and SNAM RETE in Italy. At present, there is no equivalent product competition. There are instruments like gas chromatographs, but they are slower and more complicated to use and as much as double the price of the GasPT system.

**Philanthropic Philosophy**

In an industry first, CUI has chosen that, in addition to sales commission, sales representative firms will also receive a charity commission to be donated to charities of their choice. One of CUI’s core values is generosity, which includes philanthropic giving. We give in our local community and we want to also give in the communities in which we do business.

**Item 1A. Risk Factors**

**RISK FACTORS**

Our business is subject to various risks and uncertainties. Investors should read carefully the following factors as well as the cautionary statements referred to in ‘‘Forward-Looking Statements’’ herein. If any of the risks and uncertainties described below or elsewhere in this annual report on Form 10-K actually occur, the Company's business, financial condition or results of operations could be materially adversely affected.

**Risks Related to Our Business and Products**

*Historically, we have generated annual losses from operations and we may need additional funding in the future*.

Historically, on an annual basis, we have not generated sufficient revenues from operations to self-fund our capital and operating requirements. For the year ended 2015, we had a net loss of $6.0 million and our accumulated deficit as of December 31, 2015 was $88.7 million. If we are not able to generate sufficient income and cash flows from operations to fund our operations and growth plans, we may seek additional capital from equity and debt placements or corporate arrangements. Additional capital may not be available on terms favorable to us, or at all. If we raise additional funds by issuing equity securities, our shareholders may experience dilution. Debt financing, if available, may involve restrictive covenants or security interests in our assets. If we raise additional funds through collaboration arrangements with third parties, it may be necessary to relinquish some rights to technologies or products. If we are unable to raise adequate funds or generate them from operations, we may have to delay, reduce the scope of, or eliminate some or all of our growth plans or liquidate some or all of our assets.

*There is no assurance we will achieve or sustain profitability*.

For the year ended December 31, 2015, we had a net loss of $6.0 million. There is no assurance that we will achieve or sustain profitability. If we fail to achieve or sustain profitability, the price of our common stock could fall and our ability to raise additional capital could be adversely affected.

*We have expanded our business activities and these activities may not be successful and may divert our resources from our existing business activities*.

Our historical business was a commoditized electromechanical parts distribution business. In recent years, we have focused our business on the acquisition, development and commercialization of new and innovative electronic technologies/products. We may not be successful in acquiring technologies that are commercially viable. We may fail to successfully develop or commercialize technologies that we acquire. Research, development and commercialization of such acquired technologies may disproportionately divert our resources from our other business activities.

*If our manufacturers or our suppliers are unable to provide an adequate supply of products, our growth could be limited and our business could be harmed*.

We rely on third parties to supply components for and to manufacture our products. In order to grow our business to achieve profitability, we will need our manufacturers and suppliers to increase, or scale-up, production and supply by a significant factor over current levels. There are technical challenges to scaling-up capacity that may require the investment of substantial additional funds by our manufacturers or suppliers and hiring and retaining additional management and technical personnel who have the necessary experience. If our manufacturers and suppliers are unable to do so, we may not be able to meet the requirements to grow our business to anticipated levels. We also may represent only a small portion of our supplier’s or manufacturer’s business, and if they become capacity constrained, they may choose to allocate their available resources to other customers that represent a larger portion of their business.

*Our international operations are subject to increased risks, which could harm our business, operating results and financial condition*.

Our ability to manage our business and conduct our operations internationally requires considerable management attention and resources and is subject to a number of risks, including the following:

- challenges caused by distance, language and cultural differences and by doing business with foreign agencies and governments;
- longer payment cycles in some countries;
- uncertainty regarding liability for services and content;
- credit risk and higher levels of payment fraud;
- currency exchange rate fluctuations and our ability to manage these fluctuations;
- foreign exchange controls that might prevent us from repatriating cash earned in countries outside the U.S.;
- import and export requirements that may prevent us from shipping products or providing services to a particular market and may increase our operating costs;
- potentially adverse tax consequences;
- higher costs associated with doing business internationally;
- political, social and economic instability abroad, terrorist attacks and security concerns in general;
- reduced or varied protection for intellectual property rights in some countries; and
- different employee/employer relationships and the existence of workers' councils and labor unions.

In addition, compliance with complex foreign and U.S. laws and regulations that apply to our international operations increases our cost of doing business in international venues and could expose us or our employees to fines and penalties. These numerous and sometimes conflicting laws and regulations include import and export requirements, content requirements, trade restrictions, tax laws, sanctions, internal and disclosure control rules, data privacy requirements, labor relations laws, U.S. laws such as the Foreign Corrupt Practices Act and local laws prohibiting corrupt payments to governmental officials. Violations of these laws and regulations could result in fines, civil and criminal penalties against us, our officers or our employees, prohibitions on the conduct of our business and damage to our reputation. Any such violations could include prohibitions on our ability to offer our products and services in one or more countries and could also materially damage our reputation, our brand, our international expansion efforts, our ability to attract and retain employees, our business and our operating results.

*Our revenues depend on key customers and suppliers*.

The Company's major product lines in 2015, 2014 and 2013 were power and electromechanical products and natural gas infrastructure and high-tech solutions.

During 2015, over 31% of revenues were derived from two customers, Digikey Electronics at 20%, and National Grid at 11%. During 2014, 46% of revenues were derived from two customers, Digikey Electronics at 30%, and National Grid at 16%. During 2013, 50% of revenues were derived from two customers, Digikey Electronics at 33%

and National Grid at 17%.

At December 31, 2015, of the gross trade accounts receivable totaling approximately $14.8 million, 11% was due from one customer: National Grid. At December 31, 2014, of the gross trade accounts receivable totaling approximately $10.2 million, 34% was due from two customers in the Energy segment: National Grid at 19% and Scotia Gas Networks plc at 15% and 10% was from a customer in the Power and Electromechanical segment: Digikey Electronics

During 2014, the Company had one supplier concentration of 11% related to inventory product received.

With the United Kingdom operations of Orbital, the Company also has foreign revenue and trade accounts receivable concentrations in the United Kingdom of 25% and 28%, respectively for the year ended December 31, 2015 and 34% and 54%, respectively for the year ended December 31, 2014.

There is no assurance that we will continue to maintain all of our existing key customers in the future. Should we, for any reason, discontinue our business relationship with any one of these key customers, the impact to our revenue stream would be substantial. For additional information on our concentrations, see note 17 – Concentrations.

*We rely on third-party distributors to generate a substantial part of our revenue and, if we fail to expand and manage our distribution channels, our revenues could decline and our growth prospects could suffer*.

We derive a substantial portion of our revenues from sales of our electronic component products through distributors and we expect that sales through these distributors will represent a substantial portion of our revenues for the foreseeable future. Our ability to expand our distribution channels depends in part on our ability to educate our distributors about our products, which are complex. Many of our distributors have established relationships with our competitors. If our distributors choose to place greater emphasis on products and services of their own or those offered by our competitors, our ability to grow our business and sell our products may be adversely affected. If our distributors do not effectively market and sell our products, or if they fail to meet the needs of our customers, then our ability to grow our business and sell our products may be adversely affected. The loss of one or more of our larger distributors, which may cease marketing our products with limited or no notice and our possible inability to replace them, could adversely affect our sales. Our failure to recruit additional distributors or any reduction or delay in their sales of our products or conflicts between distributor sales and our direct sales and marketing activities could materially and adversely affect our results of operations.

*We are a relatively small specialty component and solutions business and face formidable competition*.

We define our product offerings into two categories: **Power and Electromechanical Segment** (power supply units) that includes our Novum Digital Power and components including our AMT modular encoder and our **Energy Segment**, which includes the GasPT, VE Probe and IRIS among other energy related products. We are a relatively small company with limited capitalization in comparison to many of our international competitors. Because of our size and capitalization, we believe that we have not yet established sufficient market awareness in the specialty electronic component and solutions business that is essential to our continued growth and success in all of our markets. We face formidable competition in every aspect of our specialty component and solutions business from other companies many of whom have greater name recognition, more resources and broader product offerings than ours.

We also expect competition to intensify in the future. For example, the market for our electronic components and our inferential natural gas monitoring device, the GasPT, is emerging and is characterized by rapid technological change, evolving industry standards, frequent new product introductions and shortening product life cycles. Our future success in keeping pace with technological developments and achieving product acceptance depends upon our ability to enhance our current products and to continue to develop and introduce new product offerings and enhanced performance features and functionality on a timely basis at competitive prices. Our inability, for technological or other reasons, to enhance, develop, introduce or deliver compelling products in a timely manner, or at all, in response to changing market conditions, technologies or customer expectations, could have a material adverse effect on our operating results and growth prospects. Our ability to compete successfully will depend in large measure on our ability to maintain a technically skilled development and engineering staff and to adapt to technological changes and advances in the industry, including providing for the continued compatibility of our products with evolving industry standards and protocols in a competitive environment.

*Acquisitions could result in operating difficulties, dilution and other harmful consequences.*

We continue our process of integrating recent acquisitions into our own business model and we expect to continue to evaluate and enter into discussions regarding a wide array of potential strategic transactions. These transactions could be material to our financial condition and results of operations. The process of integrating an acquired company, business or technologies may create unforeseen operating difficulties and expenditures. The areas where we face risks include:

- implementation or remediation of controls, procedures and policies of the acquired company;
- diversion of management time and focus from operating our business to acquisition integration challenges;
- coordination of product, engineering and sales and marketing functions;
- transition of operations, users and customers into our existing customs;
- cultural challenges associated with integrating employees from the acquired company into our organization;
- retention of employees from the businesses we acquire;
- integration of the acquired company’s accounting, management information, human resource and other administrative systems;
- liability for activities of the acquired company before the acquisition, including patent and trademark infringement claims, violations of laws, commercial disputes, tax liabilities and other known and unknown liabilities;
- litigation or other claims in connection with the acquired company, including claims from terminated employees, customers, former shareholders, or other third parties;
- in the case of foreign acquisitions, the need to integrate operations across different cultures and languages and to address the particular economic, currency, political and regulatory risks associated with specific countries;
- failure to successfully further develop the acquired technologies; and
- other as yet unknown risks that may impact our business.

Our failure to address these risks or other problems encountered in connection with our past or future acquisitions could cause us to fail to realize the anticipated benefits of such acquisitions, incur unanticipated liabilities and harm our business generally. For example, a majority of Orbital’s revenues for each of its last two fiscal years has come from a few customers. If we fail to continue to do business with Orbital’s primary customers at substantially similar or greater levels than recent historical levels, our financial condition, results of operations and growth prospects would be significantly harmed.

Future acquisitions could also result in dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities or amortization expenses, write-offs of goodwill, or reductions to our tangible net worth any of which could harm our business, financial condition, results of operations and prospects. Also, the anticipated benefit of many of our acquisitions may not materialize.

*We will need to grow our organization and we may encounter difficulties in managing this growth.*

As of December 31, 2015, the Company, together with its consolidated subsidiaries, had approximately 350 full-time employees, which is an increase of approximately 150 from the prior year-end. We expect to experience significant growth in the number of our employees and the scope of our operations. To manage our anticipated future growth, we must continue to implement and improve our managerial, operational and financial systems, expand our facilities and continue to recruit and train additional qualified personnel. Also, our management may need to divert a disproportionate amount of its attention away from our day-to-day activities and devote a substantial amount of time to managing these growth activities. Due to our limited resources, we may not be able to effectively manage the expansion of our operations or recruit and train additional qualified personnel, which may result in weaknesses in our infrastructure, give rise to operational mistakes, loss of business opportunities, loss of employees and reduced productivity among remaining employees. The physical expansion of our operations may lead to significant costs and may divert financial resources from other projects, such as the development of new products. If our management is unable to effectively manage our expected growth, our expenses may increase more than expected, our ability to generate or increase our revenue could be reduced and we may not be able to implement our business strategy. Our future financial performance and our ability to commercialize new products including the GasPT, VE, IRIS, and Novum advanced power products and compete effectively will depend, in part, on our ability to effectively manage any future growth.

*Our operating results will vary over time and such fluctuations could cause the market price of our common stock to decline.*

Our operating results may fluctuate significantly due to a variety of factors, many of which are outside of our control. Because revenues for any future period are not predictable with any significant degree of certainty, you should not rely on our past results as an indication of our future performance. If our revenues or operating results fall below the expectations of investors or securities analysts or below any estimates we may provide to the market, the price of our common shares would likely decline substantially. Factors that could cause our operating results and stock price to fluctuate include:

- varying demand for our products due to the financial and operating condition of our distributors and their customers, distributor inventory management practices and general economic conditions;
- inability of our contract manufacturers and suppliers to meet our demand;
- success and timing of new product introductions by us and the performance of our products generally;
- announcements by us or our competitors regarding products, promotions or other transactions;
- costs related to responding to government inquiries related to regulatory compliance;
- our ability to control and reduce product costs;

- changes in the manner in which we sell products;

- volatility in foreign exchange rates, changes in interest rates and/or the availability and cost of financing or other working capital to our distributors and their customers; and
- the impact of write downs of excess and obsolete inventory.

*Our operating expenses will increase as we make further expenditures to enhance and expand our operations in order to support additional growth in our business and national stock market reporting and compliance obligations*.

Historically, we limited our investment in operations, but in the future we expect our operations and marketing investments to increase substantially to support our anticipated growth and as a result of our listing on the NASDAQ Stock Market. We are making significant investments in using more professional services and expanding our operations outside the United States. We intend to make additional investments in personnel and continue to expand our operations to support anticipated growth in our business. In addition, we may determine the need in the future to build a direct sales force to market and sell our products or provide additional resources or cooperative funds to our distributors. Such changes to our existing sales model would likely result in higher selling, general and administrative expenses as a percentage of our revenues. We expect our increased investments to adversely affect operating income in the short term while providing long-term benefit.

*Our business depends on a strong brand and failing to maintain and enhance our brand would hurt our ability to expand our base of distributors, customers and end-users*.

We believe that we have not yet established sufficient market awareness in the electronic component market. Market awareness of our capabilities and products is essential to our continued growth and our success in all of our markets. We expect the brand identity that we have developed through CUI, GasPT, Orbital Gas Systems, IRIS, Novum, AMT, and CUI Japan to significantly contribute to the success of our business. Maintaining and enhancing these brands is critical to expanding our base of distributors, customers and end-users. If we fail to maintain and enhance our brands, or if we incur excessive expenses in this effort, our business, operating results and financial condition will be materially and adversely affected. Maintaining and enhancing our brands will depend largely on our ability to be a technology leader and continue to provide high-quality products, which we may not do successfully.

*New entrants and the introduction of other distribution models in our markets may harm our competitive position*.

The markets for development, distribution and sale of our products are rapidly evolving. New entrants seeking to gain market share by introducing new technology and new products may make it more difficult for us to sell our products and could create increased pricing pressure, reduced profit margins, increased sales and marketing expenses or the loss of market share or expected market share, any of which may significantly harm our business, operating results and financial condition.

*Adverse conditions in the global economy and disruption of financial markets may significantly restrict our ability to generate revenues or obtain debt or equity financing*.

The global economy continues to experience volatility and uncertainty and governments in many countries continue to evaluate and implement spending cuts designed to reduce budget deficits. These conditions and deficit reduction measures could reduce demand for our products and services, including through reduced government infrastructure projects, which would significantly jeopardize our ability to achieve our sales targets. These conditions could also affect our potential strategic partners, which in turn, could make it more difficult to execute a strategic collaboration. Moreover, volatility and disruption of financial markets could limit our customers' ability to obtain adequate financing or credit to purchase and pay for our products and services in a timely manner, or to maintain operations and result in a decrease in sales volume. General concerns about the fundamental soundness of domestic and international economies may also cause customers to reduce purchases. Changes in governmental banking, monetary and fiscal policies to restore liquidity and increase credit availability may not be effective. Economic conditions and market turbulence may also impact our suppliers' ability to supply sufficient quantities of product components in a timely manner, which could impair our ability to fulfill sales orders. It is difficult to determine the extent of the economic and financial market problems and the many ways in which they may affect our suppliers, customers, investors and business in general. Continuation or further deterioration of these financial and macroeconomic conditions could significantly harm sales, profitability and results of operations.

*<u>One of our subsidiaries and certain suppliers are in Japan and located in areas subject to natural disasters or other events that could stop us from having our products made or shipped or could result in a substantial delay in our production or development activities</u>.*

We have sales, development and manufacturing resources in Japan. The risk of earthquakes, typhoons and other natural disasters in this geographic area is significant due to the proximity of major earthquake fault lines. Despite precautions taken by us and our third-party providers, a natural disaster or other unanticipated problems, at our location in Japan or a third-party provider could cause interruptions in the products that we provide. Any disruption resulting from these events could cause significant delays in shipments of our products until we are able to shift our manufacturing, assembly or testing from the affected contractor to another third party vendor. We cannot assure you that alternative capacity could be obtained on favorable terms, if at all.

*<u>Defects in our products could harm our reputation and business</u>.*

Our electronic products are complex and have contained and may contain undetected defects or errors, especially when first introduced or when new versions are released. Defects in our products may lead to product returns and require us to implement design changes or updates.

Any defects or errors in our electronic products, or the perception of such defects or errors, could result in:

- expenditure of significant financial and product development resources in efforts to analyze, correct, eliminate or work around errors or defects;
- loss of existing or potential customers or distributors;
- delayed or lost revenue;
- delay or failure to attain market acceptance;
- delay in the development or release of new products or services;
- negative publicity, which will harm our reputation;
- warranty claims against us;
- an increase in collection cycles for accounts receivable, which could result in an increase in our provision for doubtful accounts and the risk of costly litigation; and
- harm to our results of operations.

*We and our contract manufacturers purchase some components, subassemblies and products from a limited number of suppliers. The loss of any of these suppliers may substantially disrupt our ability to obtain orders and fulfill sales as we design and qualify new components*.

We rely on third party components and technology to build and operate our products and we rely on our contract manufacturers to obtain the components, subassemblies and products necessary for the manufacture of our products. Shortages in components that we use in our products are possible and our ability to predict the availability of such components is limited. If shortages occur in the future, as they have in the past, our business, operating results and financial condition would be materially adversely affected. Unpredictable price increases of such components due to market demand may occur. While components and supplies are generally available from a variety of sources, we and our contract manufacturers currently depend on a single or limited number of suppliers for several components for our products. If our suppliers of these components or technology were to enter into exclusive relationships with other providers or were to discontinue providing such components and technology to us and we were unable to replace them cost effectively, or at all, our ability to provide our products would be impaired. Therefore, we may be unable to meet customer demand for our products, which would have a material adverse effect on our business, operating results and financial condition.

*We depend on key personnel and will need to recruit new personnel as our business grows*.

As a small company, our future success depends in a large part upon the continued service of key members of our senior management team who are critical to the overall management of CUI Global and our subsidiary companies, Orbital, Orbital Gas Systems, North America, Inc. CUI, Inc., CUI Japan, and CUI Canada as well as the development of our technologies, our business culture and our strategic direction. The loss of any of our management or key personnel could seriously harm our business and we do not maintain any key-person life insurance policies on the lives of these critical individuals.

If we are successful in expanding our product and customer base, we will need to add additional key personnel as our business continues to grow. If we cannot attract and retain enough qualified and skilled staff, the growth of the business may be limited. Our ability to provide services to customers and expand our business depends, in part, on our ability to attract and retain staff with professional experiences that are relevant to technology development and other functions the Company performs. Competition for personnel with these skills is intense. We may not be able to recruit or retain the caliber of staff required to carry out essential functions at the pace necessary to sustain or expand our business.

We believe our future success will depend in part on the following:

- the continued employment and performance of our senior management;
- our ability to retain and motivate our officers and key employees; and

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our ability to identify, attract, hire, train, retain and motivate other highly skilled technical, managerial, marketing, sales and customer service personnel.

**Risks Related to Our Intellectual Property and Technology**

*If we fail to protect our intellectual property rights adequately, our ability to compete effectively or to defend ourselves from litigation could be impaired*.

We rely primarily on patent, copyright, trademark and trade secret laws, as well as confidentiality and non-disclosure agreements and other methods, to protect our proprietary technologies and know-how. Given the costs of obtaining patent protection, we may choose not to protect certain innovations that later turn out to be important. Furthermore, there is always the possibility, despite our efforts, that the scope of the protection gained will be insufficient or that an issued patent may be deemed invalid or unenforceable. We license a significant amount of our underlying intellectual property from third parties, i.e., AMT Encoder Technology, Novum Digital Point of Load Technology, GasPT Technology and VE *Technology*. The loss of our rights as a licensee under any of these or future technology licensing arrangements, or the exclusivity provisions of these agreements, could have a material adverse impact upon our financial position and results of operations.

Monitoring unauthorized use of our intellectual property is difficult and costly. Unauthorized use of our intellectual property may occur in the future without our knowledge. The steps we have taken may not prevent unauthorized use of our intellectual property. Further, we may not be able to detect unauthorized use of, or take appropriate steps to enforce our intellectual property rights. Our competitors may also independently develop similar technology. Our failure to effectively protect our intellectual property could reduce the value of our technology in licensing arrangements or in cross-licensing negotiations and could impair our ability to compete. Any failure by us to meaningfully protect our intellectual property could result in competitors offering products that incorporate our most technologically advanced features, which could seriously reduce demand for our products.

We may in the future need to initiate infringement claims or litigation. Litigation, whether we are a plaintiff or a defendant, can be expensive and time-consuming and may divert the efforts of our technical staff and managerial personnel, which could result in lower revenues and higher expenses, whether or not such litigation results in a determination favorable to us.

*Confidentiality agreements with employees and others may not adequately prevent disclosure of our trade secrets and other proprietary information*.

We have devoted substantial resources to the development of our proprietary technology and trade secrets. In order to protect our proprietary technology and trade secrets, we rely in part on confidentiality agreements with our key employees, licensees, independent contractors and other advisors. These agreements may not effectively prevent disclosure of our trade secrets and may not provide an adequate remedy in the event of unauthorized disclosure of our trade secrets. We may have difficulty enforcing our rights to our proprietary technology and trade secrets, which could have a material adverse effect on our business, operating results and financial condition. In addition, others may independently discover trade secrets and proprietary information and in such cases we could not assert any trade secret rights against such parties. Costly and time consuming litigation could be necessary to determine and enforce the scope of our proprietary rights and failure to obtain or maintain trade secret protection could adversely affect our competitive business position.

*If a third party asserts that we are infringing on its intellectual property, whether successful or not, it could subject us to costly and time-consuming litigation and our business may be adversely affected*.

The technology industry is characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. Third parties may assert patent and other intellectual property infringement claims against us or the parties from whom we license our technological rights in the form of lawsuits, letters or other forms of communication. These claims, whether or not successful, could:

- divert management’s attention;
- result in costly and time-consuming litigation;

- require us to enter into royalty or licensing agreements, which may not be available on acceptable terms, or at all; and
- require us to redesign our products to avoid infringement.

As a result, any third-party intellectual property claims against us could increase our expenses and adversely affect our business. Even if we have not infringed any third parties' intellectual property rights, we cannot be sure our legal defenses will be successful and even if we are successful in defending against such claims, our legal defense could require significant financial resources and management time. Finally, if a third party successfully asserts a claim that our products infringe its proprietary rights, royalty or licensing agreements might not be available on terms we find acceptable or at all and we may be required to pay significant monetary damages to such third party.

*If our contract manufacturers do not respect our intellectual property and trade secrets, our business, operating results and financial condition could be materially adversely affected*.

Because most of our contract manufacturers operate outside the United States, where prosecution of intellectual property infringement and trade secret theft is more difficult than in the United States, certain of our contract manufacturers, their affiliates, their other customers or their suppliers may attempt to use our intellectual property and trade secrets to manufacture our products for themselves or others without our knowledge. Although we attempt to enter into agreements with our manufacturers to preclude them from using our intellectual property and trade secrets, we may be unsuccessful in monitoring and enforcing our intellectual property rights. Although we take steps to stop counterfeits, we may not be successful and customers who purchase these counterfeit goods may have a bad experience and our brand may be harmed. If such an impermissible use of our intellectual property or trade secrets were to occur, our ability to sell our products at competitive prices and to be the sole provider of our products may be adversely affected and our business, operating results and financial condition could be materially and adversely affected.

**Risks Related to Our Common Stock**

*Our common stock price may be volatile, which could result in substantial losses for individual shareholders*.

The market price for the Company's common stock is volatile and subject to wide fluctuations in response to factors, including the following, some of which are beyond our control, which means our market price could be depressed and could impair our ability to raise capital:

- actual or anticipated variations in our quarterly operating results;
- announcements of technological innovations or new products or services by the Company or our competitors;
- conditions or trends relating to our inferential natural gas monitoring device or electromechanical component technologies;
- changes in the economic performance and/or market valuations of other electromechanical, electronic component and industrial controls related companies;
- conditions or trends relating to the marketing, sale or distribution of electromechanical components and industrial controls to OEM manufacturing customers;
- changes in the economic performance and/or market valuations of other inferential natural gas monitoring device or electromechanical components and industrial electronic component related companies;
- additions or departures of key personnel;

- fluctuations of the stock market as a whole;
- announcements about our earnings that are not in line with expectations;
- announcements by our competitors of their earnings that are not in line with expectations;
- the volume of shares of common stock available for public sale;
- sales of stock by us or by our shareholders;
- short sales, hedging and other derivative transactions on shares of our common stock;

- our ability to retain existing customers, attract new customers and satisfy our customers’ requirements;
- general economic conditions;
- changes in our pricing policies;
- our ability to expand our business;
- the effectiveness of our personnel;
- new product and service introductions;
- technical difficulties or interruptions in our services;
- the timing of additional investments in our products;
- regulatory compliance costs;
- costs associated with future acquisitions of technologies and businesses; and
- extraordinary expenses such as litigation or other dispute-related settlement payments.

These factors may materially and adversely affect the market price of our common stock, regardless of our performance. In addition, the stock market in general and the market for technology companies in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may seriously harm the market price of our common stock, regardless of our actual operating performance. Additionally, because the trading volume of our stock is not large, there can be a disparity between the bid and the asked price that may not be indicative of the stock’s true value.

*Offers or availability for sale of a substantial number of shares of our common stock may cause the price of our common stock to decline*.

Sales of a significant number of shares of our common stock in the public market could harm the market price of our common stock and make it more difficult for us to raise funds through future offerings of common stock.

*We have never paid dividends on our common stock and do not expect to pay any in the foreseeable future*.

Potential purchasers should not expect to receive a return on their investment in the form of dividends on our common stock. The Company has never paid cash dividends on its common stock and the Company does not expect to pay dividends in the foreseeable future.

We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. Our payment of any future dividends will be at the discretion of our board of directors after taking into account various factors, including but not limited to our financial condition, operating results, cash needs, growth plans and the terms of any credit agreements that we may be a party to at the time. Our ability to pay dividends on our common stock is limited by our existing line of credit, and may be further restricted by the terms of any of our future debt or preferred securities. Accordingly, investors must rely on sales of their own common stock after price appreciation, which may never occur, as the only way to realize their investment. Investors seeking cash dividends should not purchase shares of our stock.

*There is a limited public trading market for our common stock so you may not be able to resell your stock and may not be able to turn your investment into cash*.

Our common stock is currently traded on the NASDAQ Stock Market under the trading symbol ‘‘CUI.’’ Our shares of common stock are thinly traded. Due to the illiquidity, the market price may not accurately reflect our relative value. There can be no assurance that there will be an active market for our shares of common stock either now or in the future. Because our common stock is thinly traded, a large block of shares traded can lead to a dramatic fluctuation in the share price and investors may not be able to liquidate their investment in us at all or at a price that reflects the value of the business.

**Risks Relating to Shareholder Rights**

*Our board of directors has the authority, without shareholder approval, to issue preferred stock with terms that may not be beneficial to existing common shareholders and with the ability to adversely affect shareholder voting power and perpetuate their control.*

Although we do not have any preferred stock outstanding presently, our Articles of Incorporation allow us to issue shares of preferred stock without any vote or further action by our shareholders. Our board of directors has the authority to issue preferred stock without further shareholder approval, as well as the authority to fix and determine the relative rights and preferences of preferred stock. As a result, our board of directors could authorize the issuance of a series of preferred stock that would grant to holders the preferred right to our assets upon liquidation, the right to receive dividend payments before dividends are distributed to the holders of common stock or other preferred shareholders and the right to the redemption of the shares, together with a premium, prior to the redemption of our common stock.

Preferred stock could be used to dilute a potential hostile acquirer. Accordingly, any future issuance of preferred stock or any rights to purchase preferred shares may have the effect of making it more difficult for a third party to acquire control of us. This may delay, defer or prevent a change of control or an unsolicited acquisition proposal. The issuance of preferred stock also could decrease the amount of earnings attributable to and assets available for distribution to, the holders of our common stock and could adversely affect the rights and powers, including voting rights, of the holders of our common stock and preferred stock.

*Our Articles of Incorporation limits director liability, thereby making it difficult to bring any action against them for breach of fiduciary duty.*

The Company is a Colorado corporation. As permitted by Colorado law, the Company's Articles of Incorporation limits the liability of directors to the Company or its shareholders for monetary damages for breach of a director's fiduciary duty, with certain exceptions. These provisions may discourage shareholders from bringing suit against a director for breach of fiduciary duty and may reduce the likelihood of derivative litigation brought by shareholders on behalf of the Company against a director.

*Our charter documents and note outstanding to IED, Inc. may inhibit a takeover that shareholders consider favorable.*

Provisions of our Articles of Incorporation and Bylaws may delay or discourage transactions involving an actual or potential change in control of the Company, including transactions in which shareholders might otherwise receive a premium for their shares, or transactions that our shareholders might otherwise deem to be in their best interests. These provisions:

- provide that the authorized number of directors may be changed by resolution of the board of directors;

- provide that all vacancies, including newly created directorships, may, except as otherwise required by law, be filled by the affirmative vote of a majority of directors then in office, even if less than a quorum; and
- do not provide for cumulative voting rights.

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Our operating subsidiary, CUI, Inc. issued a note to IED, Inc. in connection with our acquisition of CUI, Inc. The note provides that, for so long as any obligations are outstanding under the note, IED will have a right to match any bona fide offer from a third party to acquire CUI, Inc. by any means. This matching right could discourage third parties from making an offer to acquire us, which would involve indirectly acquiring CUI, Inc., or from acquiring CUI, Inc. directly, in a transaction our shareholders might find advantageous because any such offer could be matched by IED and result in the third party utilizing time and resources to formulate an offer without being able to complete a transaction.

**Risks Related to Our 2013 Acquisition of Orbital Gas Systems Limited in the United Kingdom, and our March 2015 Acquisition of CUI Canada**

*A significant portion of our total assets at Orbital Gas Systems Limited consists of goodwill, which is subject to a periodic impairment analysis, and a significant impairment determination in any future period could have an adverse effect on our results of operations even without a significant loss of revenue or increase in cash expenses attributable to such period.*

We have goodwill totaling approximately $8.5 million associated with the acquisition of Orbital Gas Systems Ltd. We are required to evaluate this goodwill for impairment based on the fair value of the operating business units to which this goodwill relates, at least once a year. This estimated fair value could change if we are unable to achieve operating results at the levels that have been forecasted, the market valuation of those business units decreases based on transactions involving similar companies, or there is a permanent, negative change in the market demand for the services offered by the business units. These changes could result in an impairment of the existing goodwill balance that could require a material non-cash charge to our results of operations.

*Our operating results may be affected by fluctuations in foreign currency exchange rates, which may affect our operating results in U.S. dollar terms*.

A portion of our revenue arises from our international operations and we anticipate that, as we grow, our revenues from international operations will increase. Revenues generated and expenses incurred by our international operations are often denominated in foreign currencies. As a result, our consolidated U.S. dollar financial statements are subject to fluctuations due to changes in exchange rates as revenues and expenses of our international operations are translated from local currencies into U.S. dollars. In addition, our financial results are subject to changes in exchange rates that impact the settlement of transactions. The Company does not currently undertake any hedges to protect against adverse foreign currency exposure.

*Our gas quality inferential measurement device, GasPT® sold by Orbital Gas Systems Ltd., has not gained market acceptance as rapidly as we anticipated. There is no assurance our acquisition of Orbital will accelerate sales of the GasPT® device.*

Our future financial performance and ability to commercialize the GasPT device and compete successfully will depend on our ability to effectively manage acceptance and introduction of our GasPT device in the natural gas quality inferential measurement device market. Although we have entered into agreements and letters of understanding with third parties, which could result in substantial sales of the GasPT device over the next several years, there is no assurance we will sell at or near the number of units forecasted under these contracts.

Several factors have and may continue to contribute to the slower than anticipated market acceptance of the GasPT device, such as: disruptive technologies, such as the GasPT device, are slow to be accepted in a mature industry, such as natural gas distribution; extensive testing and research required by large natural gas distribution customers takes an extended period of time before such potential customers place firm orders; macro-economic issues in the natural gas industry may slow or impede capital expenditures; registration, regulatory approvals, certifications and licensing requirements in foreign countries.

Our strategy has been to establish market acceptance and credibility with potential customers through a campaign of product exposure and disclosure of highly acceptable test results of recognized international testing laboratories along with industry seminars, conventions, trade shows, professional periodicals and public relations. While we believe that the base has been laid for substantial sales of our GasPT device over the next several years, there is no assurance that our strategy and efforts will be successful. Also, while our management is optimistic that the acquisition of Orbital will stimulate and accelerate sales of the GasPT device, there is no assurance that GasPT device sales will actually increase in the near future due to the Orbital acquisition.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

During September, 2013, our wholly owned subsidiary, CUI Properties, LLC, signed closing documents on the purchase of our Tualatin, Oregon corporate office real estate located at 20050 SW 112th Avenue in the Tualatin Franklin Business Park. In addition to the corporate office, the property also includes the Company's warehouse facility for CUI Inc. The purchase price for this acquisition was $5,050,000 and was partially funded by a promissory note payable to Wells Fargo Bank in the amount of $3,693,750 plus interest at the rate of 2.0% above LIBOR, payable over ten years.

In January 2015, the Company entered into a three-year lease for our 13,175 square foot Houston facility.

In March 2015, as part of the Tectrol (CUI Canada) acquisition, the Company leased a manufacturing facility in Toronto, Canada.

In September 2015, Orbital completed the construction of a new 46,000 square foot state-of-the-art manufacturing/administration/research and development facility on its existing site in the UK to supplement existing office space. This enhanced onsite facility has enabled the Company to give notice on an additional building it was leasing for manufacturing and office space requirements.

Additionally, CUI Japan has leased space in Tokyo, Japan used as a sales office.

The Company has enough manufacturing and office capacity to meet its business needs for the foreseeable future.

**Item 3. Legal Proceedings**

The Company and its subsidiaries are not parties in any legal proceedings. No director, officer or affiliate of the Company, any owner of record or beneficially of more than five percent of any class of voting securities of the Company or any associate of any such director, officer, affiliate of the Company or security holder is a party adverse to the Company or any of its subsidiaries or has a material interest adverse to the Company or any of its subsidiaries.

**Item 4. Mine Safety Disclosure**

Not applicable.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

*Description of Securities*

The Company's Common Stock is traded on The NASDAQ Stock Market under the trading symbol ''CUI.'' The Company currently has authorized 325,000,000 common shares, par value $0.001 per share, and as of December 31, 2015, the Company's issued and outstanding shares consisted of 20,806,219 shares of common stock of which 20,236,347 shares are freely tradable without restriction or limitation under the Securities Act. As of December 31, 2015, the Company had in excess of 3,000 beneficial holders of our common stock and in excess of 2,300 shareholders of record. The actual number of shareholders is greater than this number of record holders and includes shareholders who are beneficial owners, but whose shares are held in street name by brokers and other nominees.

The holders of Common Stock are entitled to one vote per share and do not have cumulative voting rights. Holders of the Company's Common Stock do not have any pre-emptive or other rights to subscribe for or purchase additional shares of capital stock and no conversion rights, redemption or sinking-fund provisions.

*Our 2013 Public Offering*

During April 2013, in conjunction with an SEC Form S-1 registration statement that became effective by the SEC on April 11, 2013, 8.4 million shares of common stock were issued. The Company received $42.0 million before related costs from this transaction. Also, during April 2013, 1.3 million additional shares were issued that are included in the S-1 registration statement pursuant to an over-allotment provision contained in our underwriting agreement. The Company received $6.3 million before related costs from the sale of the over-allotment shares. Net proceeds from the April 2013 common stock sales pursuant to the S-1 registration statement and over-allotment provision were $45.1 million after paying costs of $3.2 million, which were recorded as reductions of additional paid in capital.

*Use of Proceeds*

Effective April 1, 2013, CUI Global closed on a share purchase agreement to acquire 100% of the equity interest in Orbital Gas Systems Limited, a company organized under the laws of England and Wales (''Orbital''), from Orbital's sole shareholder. The Company completed the strategic acquisition of Orbital for 17 million British Pounds Sterling, approximately $26.2 million based on the actual exchange rate for British Pounds Sterling to U.S. dollars achieved on the date of funding – April 18, 2013.

In May 2013, the Company paid to IED, Inc. $2.0 million in principal, thereby reducing the balance of the note payable to $5.3 million. In conjunction with this payment, the maturity date of the note was extended to May 15, 2020 and the interest was reduced to 5% per annum, payable monthly, with the principal due as a balloon payment at the maturity date.

The balance of the net proceeds are intended to be used to fund working capital, short-term investments, capital expenditures and other general corporate purposes.

*Market Value*

The Company's Common Stock is traded on the NASDAQ Stock Market under the trading symbol ''CUI.'' The following table sets forth, the high and low sales prices of our Common Stock on the NASDAQ during each quarter of the two most recent years.

| | High | Low |
|---|---|---|
| 2015 | | |
| First Quarter | $7.57 | $5.17 |
| Second Quarter | 6.02 | 4.68 |
| Third Quarter | 6.02 | 4.12 |
| Fourth Quarter | 7.69 | 5.12 |
| 2014 | | |
| First Quarter | $11.34 | $6.26 |
| Second Quarter | 10.43 | 6.43 |
| Third Quarter | 8.37 | 6.04 |
| Fourth Quarter | 8.64 | 5.73 |

*Stock Performance Graph*

The following graph compares the performance of our common stock to the performance of the NASDAQ Composite Index and the Russell 2000 Index. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity markets. The comparisons in the chart below are provided in response to SEC disclosure requirements and are not intended to forecast or be indicative of future performance of our common stock.

| | Period Ending | | | | | |
|---|---|---|---|---|---|---|
| Index | 12/31/10 | 12/31/11 | 12/31/12 | 12/31/13 | 12/31/14 | 12/31/15 |
| CUI Global, Inc. | $100.00 | $76.01 | $73.20 | $84.27 | $99.33 | $93.87 |
| NASDAQ Composite | 100.00 | 99.17 | 116.48 | 163.21 | 187.27 | 200.31 |
| Russell 2000 | 100.00 | 95.82 | 111.49 | 154.78 | 162.35 | 155.18 |

* $100 invested on 12/31/10 in stock or index, including reinvestment of dividends. Fiscal year ended December 31.

Source : SNL Financial LC, Charlottesville, VA



*Dividend Policy*

The Company has never paid cash dividends on its Common Stock and the Company does not expect to pay dividends in the foreseeable future.

We currently expect to retain future earnings to finance the growth and development of our business. The timing, amount and form of future dividends, if any, will depend, among other things, on our future results of operations and cash flows; our general financial condition and future prospects; our capital requirements and surplus; contractual restrictions; the amount of distributions, if any, received by us from our subsidiaries; and other factors deemed relevant by our board of directors. Any future dividends on our common shares would be declared by and subject to the discretion of our board of directors.

*Common Stock Reserved for Future Issuances*

Set forth below is a summary of the outstanding securities, transactions and agreements, which relate to 970,847 shares of common stock the Company is required to reserve for potential future issuances.

- *970,847 common shares reserved for outstanding options issued under our Equity Compensation Plans.* As of December 31, 2015, there were reserved for issuance an aggregate of 970,847 shares of common stock for options outstanding under the Company's 2008 Equity Incentive Plan and the Company's 2009 Equity Incentive Plan (Executive).
- *1,525,862 common shares authorized for issuance under our Equity Compensation Plans*

As of December 31, 2015, the Company has 1,525,862 common shares authorized and available for issuance under the Company option plans.

The approximate 569,872 shares of Common Stock held by existing shareholders as of December 31, 2015 that are ''restricted'' within the meaning of Rule 144 adopted under the Securities Act (the ''Restricted Shares''), may not be sold unless they are registered under the Securities Act or sold pursuant to an exemption from registration, such as the exemption provided by Rule 144 promulgated under the Securities Act. The Restricted Shares were issued and sold by us in private transactions in reliance upon exemptions from registration under the Securities Act and may only be sold in accordance with the provisions of Rule 144 of the Securities Act, unless otherwise registered under the Securities Act.

Other than as described herein, as of the date of this report, there are currently no plans, arrangements, commitments or understandings for the issuance of additional shares of Common Stock.

**RECENT SALES OF UNREGISTERED SECURITIES**

Following is a list of all securities we sold within the past three years, which were not registered under the Securities Act. The Company relied on Section 4(2) of the Securities Act of 1933 as the basis for an exemption from registration for the following issuances.

**2015 Sales of Unregistered Securities**

*Common Stock Issued During 2015* (dollars in thousands)

| Date of issuance | Type of issuance | Expense/ Prepaid/ Cash | Stock issuance recipient | Reason for issuance | Total no. of shares | Grant date fair value recorded at issuance | |
|---|---|---|---|---|---|---|---|
| January 2015 | Vested restricted common stock | Expensed | Two board members | Director compensation | 5,000 | $ 36 | |
| January 2015 | Vested restricted common stock | Expensed | New Director of Sales and Marketing - Orbital Gas Systems, North America | Sign-on bonus | 17,655 | 125 | |
| March 2015 | Vested restricted common stock | $31 thousand included in Prepaid expense and $32 thousand expensed | Consultant | Compensation for strategic investor marketing services | 10,000 | 63 | |
| April 2015 | Common stock | Expensed | Former employee | Cashless stock option exercise | 108 | - | (1) |
| May 2015 | Vested restricted common stock | Expensed | Employee | Approved bonus | 1,391 | 7 | |
| June 2015 | Vested restricted common stock | Expensed | Employee | Approved bonus | 9,560 | 50 | |
| June 2015 | Vested restricted common | Expensed | Director | Director compensation | 1,753 | 10 | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | stock | | | | | | |
| July 2015 | Vested restricted common stock | Expensed | Employee | Bonus compensation | 3,453 | 15 | |
| July 2015 | Common stock | Expensed | Related party, James McKenzie | Pursuant to royalty agreement | 3,670 | 20 | |
| July 2015 | Common stock | Expensed | Related party, IED, Inc. | Pursuant to royalty agreement | 400 | 2 | |
| August 2015 | Common stock | Expensed | Employee | Cashless stock option exercise | 14 | - | (1) |
| August 2015 | Vested restricted common stock | Expensed | Director | Director compensation | 4,497 | 25 | |
| November 2015 | Vested restricted common stock | Expensed | Director | Director compensation | 978 | 6 | |
| Total 2015 issuances | | | | | 58,479 | $ 359 | (2) |

(1) The Company received $0 for the issuance in the cashless option exercise.

(2) There was $404 thousand of stock-based expense related to employee stock-based bonuses and vested restricted stock units earned in 2015 but not issued until the first quarter of 2016.

**2014 Sales of Unregistered Securities**

*Common Stock Issued During 2014* (dollars in thousands)

| Dates of issuance | Type of issuance | Expense/ Prepaid | Stock issuance recipient | Reason for issuance | Total no. of shares | Grant date fair value recorded at issuance |
|---|---|---|---|---|---|---|
| January, February, March, April and November 2014 | Common stock | Expensed | Three employees, one officer and one former director | Cashless stock option exercises | 31,850 | $ - |
| February, March, August and December 2014 | Common stock | Expensed | Four consultants including former director | Consideration for services | 131,365 | 932 |
| March and December 2014 | Common stock | Expensed | Related party, James McKenzie | Pursuant to royalty agreement | 4,555 | 31 |
| June 2014 | Common stock | Expensed | Employee | Bonus | 5,624 | 50 |
| August 2014 | Common stock | Expensed | Three directors | Director compensation | 6,435 | 48 |
| December 2014 | Common stock | Expensed | Director | Director compensation | 1,248 | 10 |
| Total 2014 Issuances | | | | | 181,077 | $ 1,071 |

*Options Issued During 2014*

In January 2014, the Company issued as equity compensation under the 2009 Equity Incentive Plan (Executive) to each board member who is not an employee of the Company, options to purchase 10 thousand shares of restricted common stock with the following assumptions: exercise price of $6.92 per share, volatility of 34%, risk-free interest rate of 1.72% and a term of five years. These options vested in twelve equal installments during 2014.

In January 2014, the Company issued under the 2009 Equity Incentive Plan (Executive) to two board members, who chose to receive a portion of their annual cash board compensation in the form of equity, options to purchase 42,890 restricted shares of common stock with the following assumptions: exercise price of $6.92 per share, volatility of 34%, risk-free interest rate of 1.72% and a term of five years. These options vested over six months during 2014.

In August 2014, the Company issued fully vested sign-on bonus option grants to each of two newly elected directors to purchase 7,500 restricted shares of common stock at a price of $8.15 per share with the following assumptions: exercise price of $8.15 per share, volatility of 61%, risk-free interest rate of 1.63% and a term of five years.

**2013 Sales of Unregistered Securities**

*Common Stock Issued During 2013* (dollars in thousands)

| Dates of issuance | Type of issuance | Expense/ Prepaid | Stock issuance recipient | Reason for issuance | Total no. of shares | Grant date fair value recorded at issuance |
|---|---|---|---|---|---|---|
| June 2013 | Common stock | Expensed | 22 employees | Bonus | 16,305 | $ 91 |
| June 2013 | Common stock | Expensed | Related party, James McKenzie | Pursuant to royalty agreement | 4,578 | 25 |
| December 2013 | Common stock | Expensed | Consultant | Consideration for services | 2,500 | 16 |
| Total 2013 Issuances | | | | | 23,383 | $ 132 |

*Warrants and Options Issued During 2013*

In June 2013 options to purchase 350,000 shares of restricted common stock at a price of $6.25 per share were granted to three officers under the 2009 Equity Incentive Plan (Executive) valued using the following assumptions: exercise price of $6.25 per share, volatility of 44%, risk-free interest rate of 0.73% and a term of five years. These options vest: one third per year beginning at one year from the date of grant.

**Shares Eligible for Future Sale**

As of December 31, 2015, we had outstanding 20,806,219 shares of Common Stock. Of these shares, 20,236,347 shares are freely tradable without restriction or limitation under the Securities Act.

The 569,872 shares of Common Stock held by existing shareholders as of December 31, 2015 that are ‘‘restricted’’ within the meaning of Rule 144 adopted under the Securities Act (the ‘‘Restricted Shares’’), may not be sold unless they are registered under the Securities Act or sold pursuant to an exemption from registration, such as the exemption provided by Rule 144 promulgated under the Securities Act. The Restricted Shares were issued and sold by us in private transactions in reliance upon exemptions from registration under the Securities Act.

**Item 6. Selected Financial Data**

The following tables set forth selected consolidated financial data as of the dates and for the periods presented. The selected consolidated balance sheet data as of December 31, 2015 and 2014 and the selected consolidated statement of operations data for the years ended December 31, 2015, 2014, and 2013 have been derived from our audited consolidated financial statements and related notes that we have included elsewhere in this filing. The selected consolidated balance sheet data as of December 31, 2013, 2012, and 2011 and the selected consolidated statement of operations data for the years ended December 31, 2012 and 2011 have been derived from audited consolidated financial statements that are not presented in this filing. The timing of acquisitions and divestitures completed during the years presented affects the comparability of the selected financial data. The selected financial data excludes the operations as well as assets and liabilities of our discontinued operations from our consolidated financial statements.

The selected historical consolidated financial data as of any date and for any period are not necessarily indicative of the results that may be achieved as of any future date or for any future period. You should read the following selected historical financial data in conjunction with the more detailed information contained in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the related notes that we have presented elsewhere in this filing.

For information regarding the Company's acquisitions, see Note 4, ACQUISITION.

| (in thousands, except share and per share amounts) | For the Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| Selected Statements of Operations Data: | | | | | |
| Total revenues | $86,667 | $76,045 | $60,652 | $41,085 | $38,938 |
| Cost of revenues | 54,375 | 47,494 | 37,147 | 25,959 | 24,133 |
| Selling, general and administrative, depreciation and amortization | 35,885 | 30,121 | 22,457 | 15,971 | 13,348 |
| Research and development | 1,848 | 1,306 | 943 | 791 | 716 |
| Provision for (credit to) bad debt | 195 | (39) | 211 | 66 | 82 |
| Impairment of assets (a) | 4 | 32 | - | 278 | - |
| Other income (expense) | (387) | (27) | 156 | 76 | 15 |
| Derivative income (expense) (b) | 20 | (172) | (428) | - | - |
| Gain on sale of technology rights (c) | - | - | - | - | 144 |
| Impairment on note receivable (d) | - | - | 502 | - | - |
| Earnings from investment | 53 | 49 | 25 | 60 | 41 |
| Interest expense - amortization of debt offering costs and debt discount | - | - | 43 | 73 | 335 |
| Interest expense | 441 | 508 | 443 | 575 | 918 |
| (Loss) before taxes | (6,395) | (3,527) | (1,341) | (2,492) | (394) |
| Provision (benefit) for taxes | (408) | (726) | (398) | 34 | 30 |
| Consolidated (loss) from continuing operations | $(5,987) | $(2,801) | $(943) | $(2,526) | $(424) |
| Basic and diluted (loss) per common share | $(0.29) | $(0.14) | $(0.05) | $(0.25) | $(0.06) |

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| Selected Balance Sheet Data: | | | | | |
| Cash and cash equivalents | $7,267 | $11,704 | $16,576 | $3,040 | $177 |
| Short-term investments held to maturity | - | 11,160 | 10,869 | - | - |
| Total current assets | 38,157 | 43,126 | 44,684 | 13,229 | 8,118 |
| Total assets | 90,848 | 93,054 | 99,160 | 36,723 | 31,978 |
| Total current liabilities | 17,055 | 12,355 | 15,296 | 4,657 | 9,078 |
| Total liabilities | 31,332 | 27,084 | 30,602 | 14,761 | 22,182 |
| Total Stockholders' equity | 59,516 | 65,970 | 68,558 | 21,962 | 9,796 |
| Preferred shares outstanding | - | - | - | - | 50,543 |
| Common shares outstanding | 20,806,219 | 20,747,740 | 20,566,663 | 10,883,280 | 7,314,513 |

(a) During the year ended December 31, 2014, management determined that an impairment of $32 thousand was necessary related to intangible, technology rights for a product line that was determined to have a shortened expected life. During the year ended December 31, 2012, management determined that an impairment of $0.3 million related to intangible, trademark and trade name V-Infinity was necessary.

(b) In October 2013, in conjunction with the financing of the purchase of the headquarters facility, the purchase was funded, in part, by a promissory note payable to Wells Fargo Bank in the amount of $3.7 million plus interest at the rate of 2% above LIBOR, payable over ten years. It was secured by a deed of trust on the purchased property, which was executed by CUI Properties, LLC and guaranteed by CUI Global, Inc. In conjunction with the purchase, the parties to this transaction entered into a Swap Transaction Confirmation agreement effective October 1, 2013 incorporating the terms and definitions of the International Swaps and Derivatives Association, Inc. (ISDA) that effectively caps the annual interest rate at 6.27%. The Company recorded $20 thousand of income related to the Swap derivative in 2015 and expense in 2014 and 2013 of $0.2 million and $0.4 million, respectively.

(c) During the year ended December 31, 2011, in an effort to concentrate our business focus on our core product development and marketing, we conveyed our WayCool and WayFast patent portfolio to Olantra Fund X LLC for a cash payment of $0.5 million and recognized a gain on sale of technology rights of $0.1 million.

(d) During 2013, it was determined that the note receivable related to the divestment of Comex Electronics had become impaired, at which time the Company recorded an impairment of $0.5 million.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*Important Note about Forward-Looking Statements*

The following discussion and analysis should be read in conjunction with our audited consolidated financial statements as of December 31, 2015 and notes thereto included in this document and our unaudited 10-Q filings for the first three quarters of 2015 and the notes thereto. In addition to historical information, the following discussion and other parts of this Form 10-K contain forward-looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking information due to factors discussed elsewhere in this Form 10-K.

The statements that are not historical constitute ‘‘forward-looking statements.’’ Said forward-looking statements involve risks and uncertainties that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements, expressed or implied by such forward-looking statements. These forward-looking statements are identified by the use of such terms and phrases as ‘‘expects,’’ ‘‘intends,’’ ‘‘goals,’’ ‘‘estimates,’’ ‘‘projects,’’ ‘‘plans,’’ ‘‘anticipates,’’ ‘‘should,’’ ‘‘future,’’ ‘‘believes,’’ and ‘‘s

The variables, which may cause differences include, but are not limited to, the following: general economic and business conditions; competition; success of operating initiatives; operating costs; advertising and promotional efforts; the existence or absence of adverse publicity; changes in business strategy or development plans; the ability to retain management; availability, terms and deployment of capital; business abilities and judgment of personnel; availability of qualified personnel; labor and employment benefit costs; availability and costs of raw materials and supplies; and changes in, or failure to comply with various government regulations. Although the Company believes that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the assumptions could be inaccurate; therefore, there can be no assurance that the forward-looking statements included in this Form 10-K will prove to be accurate.

In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by the Company or any person that the objectives and expectations of the Company will be achieved.

**Overview**

CUI Global, Inc. is a Colorado corporation organized on April 21, 1998. The Company’s principal place of business is located at 20050 SW 112th Avenue, Tualatin, Oregon 97062, phone (503) 612-2300. CUI Global is a platform company dedicated to maximizing shareholder value through the acquisition, development and commercialization of new, innovative technologies. Through its subsidiaries, CUI Global has built a diversified portfolio of industry leading technologies that touch many markets.

**Critical Accounting Policies**

Our financial statements and related public financial information are based on the application of accounting principles generally accepted in the United States (‘‘GAAP’’). GAAP requires the use of estimates, assumptions, judgments and subjective interpretations of accounting principles that have an impact on the assets, liabilities, revenue, and expense amounts reported. These estimates can also affect supplemental information contained in our external disclosures including information regarding contingencies, risk and financial condition. We believe our use of estimates and underlying accounting assumptions adhere to GAAP and are consistently and conservatively applied. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ materially from these estimates under different assumptions or conditions. We continue to monitor significant estimates made during the preparation of our financial statements.

While all of our significant accounting policies impact the Company's financial condition and results of operations, we view certain of these policies as critical. Policies determined to be critical are those policies that have the most significant impact on our financial statements and require management to use a greater degree of judgment and estimates. Actual results may differ from those estimates. Our management believes that given current facts and circumstances, it is unlikely that applying any other reasonable judgments or estimate methodologies would have caused a material change in our results of operations, financial position or liquidity for the periods presented in this report.

*Asset Impairment*

The Company reviews its long-lived assets including finite-lived intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset exceeds its fair value and may not be recoverable. In performing the review for recoverability, the Company estimates the future cash flows expected to result from the use of the asset and its eventual disposition. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized as the excess of the carrying amount over the fair value. Otherwise, an impairment loss is not recognized. Management estimates the fair value and the estimated future cash flows expected. Any changes in these estimates could impact whether there was impairment and the amount of the impairment. During the year ended December 31, 2015, management recorded a $2 thousand impairment for a patent within the Power and electromechanical segment as the Company chose not to continue pursuit of the related patent grants. In the fourth quarter of 2015, the Company recorded a $2 thousand impairment of its capitalized website costs for its Japan site after choosing to translate its U.S-based website into Japanese. No other impairment of other long-lived assets were identified as of December 31, 2015. During the year ended December 31, 2014, management identified an indefinite-lived intangible technology rights asset for which its expected life was reduced and an impairment of $32 thousand was recorded. During the year ended December 31, 2013, management recorded an impairment of $0.5 million for the remaining balance of a note receivable from the divestment of Comex Electronics.

*Indefinite-Lived Intangibles and Goodwill Assets*

The Company accounts for business combinations under the acquisition method of accounting in accordance with ASC 805, ``Business Combinations," where the total purchase price is allocated to the tangible and identified intangible assets acquired and liabilities assumed based on their estimated fair values. The purchase price is allocated using the information currently available, and may be adjusted, up to one year from acquisition date, after obtaining more information regarding, among other things, asset valuations, liabilities assumed and revisions to preliminary estimates. The purchase price in excess of the fair value of the tangible and identified intangible assets acquired less liabilities assumed is recognized as goodwill.

The Company tests for indefinite-lived intangibles and goodwill impairment in the second quarter of each year and whenever events or circumstances indicate that the carrying amount of the asset exceeds its fair value and may not be recoverable. The Company's qualitative assessment of impairment for indefinite-lived assets at May 31, 2015, followed the guidance in ASC 350-30-35-18A and 18B. In accordance with its policies, the Company performed a qualitative assessment of indefinite-lived intangibles and goodwill at May 31, 2015, and determined there was no impairment of indefinite-lived intangibles and goodwill.

CUI Global has adopted ASU 2011-08, which simplifies how an entity is required to test goodwill for impairment. The ASU allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under this ASU, CUI Global is not required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The ASU includes a number of factors to consider in conducting the qualitative assessment. We adopted ASU 2011-08 during the year ended December 31, 2013. The adoption of ASU 2011-08 did not have an impact on our consolidated financial statements. The Company tests for goodwill impairment in the second quarter of each year and whenever events or changes in circumstances indicate that the carrying amount of the asset exceeds its fair value and may not be recoverable.

As detailed in ASC 350-20-35-3A, in performing its testing for goodwill, management completes a qualitative analysis to determine whether it was more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. To complete this review, management follows the steps in ASC 350-20-35-3C to evaluate the fair values of the intangibles and goodwill and considers all known events and circumstances that might trigger an impairment of goodwill. In 2013, 2014 and 2015, the analysis, determined that there was no impairment necessary to goodwill. Through these reviews, management concluded that there were no events or circumstances that triggered an impairment (and there was no expectation that a reporting unit or a significant portion of a reporting unit would be sold or otherwise disposed of in the following year), therefore, no further analysis was necessary to prepare for goodwill impairment beyond the steps in 350-20-35-3C in accordance with ASU 2011-08.

*Stock-Based Compensation*

The Company accounts for stock-based compensation using FASB Accounting Standards Codification No. 718 (''FASB ASC 718''), ''Compensation – Stock Compensation.'' FASB Codification No. 718 requires the fair value of all stock-based employee compensation awarded to employees to be recorded as an expense over the related vesting period. Employee stock compensation is recorded at fair value using the Black-Scholes Pricing Model. The underlying assumptions used in the Black-Scholes Pricing Model by the Company are taken from publicly available sources including: (1) volatility, which is calculated using historic stock price information from online finance websites such as Google Finance and Yahoo Finance; (2) the stock price on the date of grant is obtained from online finance websites such as those previously noted; (3) the appropriate discount rates are obtained from the United States Federal Reserve economic research and data website; and (4) other inputs are determined based on previous experience and related estimates. With regards to the January 2014 options grant, the Company determined expected volatility by reviewing historical share prices for CUI Global for the most recent 12-month period. We determined that the most recent 12-month period of stock price fluctuations best reflected the expected volatility for determining the fair value of our stock options due to the significant changes to the Company, including the 2013 equity raise, acquisition of Orbital, increased institutional ownership and other such factors that have impacted volatility. For the August 2014 options grant, the Company extended the volatility historical period to twenty months as the Company had remained consistent with regards to the aforementioned factors. The Company may continue to change its expected volatility factor to include a longer historical period, once the Company has remained consistent with regards to the aforementioned factors.

*Valuation of Non-Cash Capital Stock Issuances*

The Company values its stock transactions based upon the fair value of the equity instruments. Various methods can be used to determine the fair value of an equity instrument. The Company may use the fair value of the consideration received, the quoted market price of the stock or a contemporaneous cash sale of the common or preferred stock. Each of these methods may produce a different result. Management uses the method it determines most appropriately reflects the stock transaction. If a different method was used it could impact the expense and equity stock accounts.

*Revenue Recognition*

-

*Power and Electromechanical segment*

Product revenue is recognized in the period when persuasive evidence of an arrangement with a customer exists, the products are shipped and title has transferred to the customer, the price is fixed or determinable, and collection is reasonably assured. The Company sells to distributors pursuant to distribution agreements that have certain terms and conditions such as the right of return and price protection, which inhibit revenue recognition unless they can be reasonably estimated as we cannot assert the price is fixed and determinable and estimate returns. For one distributor that comprises 20% of revenue, we have such history and ability to estimate and therefore recognized revenue upon sale to the distributor and record a corresponding reserve for the estimated returns. For two other distributor arrangements that represents a combined 7% of revenue, we do not have sufficient history to reasonably estimate price protection reserve and the right of return and accordingly defer revenue and the related costs until such time as the distributor resells the product.

*Energy segment*

For Production-type contracts meeting the Company’s minimum threshold, revenues and related costs on the contracts, are recognized using the ‘‘percentage of completion method’’ of accounting in accordance with ASC 605-35, *Accounting for Performance of Construction-Type and Certain Production Type Contracts* (‘‘ASC 605-35’’). Under this method, contract revenues and related expenses are recognized over the performance period of the contract in direct proportion to the costs incurred as a percentage of total estimated costs for the entirety of the contract. Costs include direct material, direct labor, subcontract labor and any allocable indirect costs. The Company captures certain job costs as work progresses, including labor, material and costs not invoiced. Margin adjustments are made as information pertaining to contracts changes. All un-allocable indirect costs and corporate general and administrative costs are charged to the periods as incurred. The amount of costs not invoiced is captured to ensure an estimated margin consistent with that expected at the completion of the project. In the event a loss on a contract is foreseen, the Company recognizes the loss when it is determined. Contract costs plus recognized profits are accumulated as deferred assets, and billings and/or cash received are recorded to a deferred revenue liability account. The net of these two accounts for any individual project is presented as ‘‘Costs in excess of billings,’’ an asset account, or ‘‘Billings in excess of costs,’’ a liability account.

Production type contracts that do not qualify for use of the percentage of completion method are accounted for using the ‘‘completed contract method’’ of accounting in accordance with ASC 605-35-25-57. Under this method, contract costs are accumulated as deferred assets, and billings and/or cash received is recorded to a deferred revenue liability account, during the periods of construction, but no revenues, costs, or profits are recognized in operations until the period within which completion of the contract occurs. A contract is considered complete when all costs except insignificant items have been incurred; the equipment is operating according to specifications and has been accepted by the customer.

For product sales in the Energy segment, revenue is recognized in the period when persuasive evidence of an arrangement with a customer exists, the products are shipped and title has transferred to the customer, the price is fixed or determinable, and collection is reasonably assured.

Revenues from warranty and maintenance activities are recognized ratably over the term of the warranty and maintenance period and the unrecognized portion is recorded as deferred revenue.

**Liquidity and Capital Resources**

<u>General</u>

As of December 31, 2015, CUI Global held Cash and cash equivalents of $7.3 million. Operations, other intangible assets, investments, equipment and our acquisition and startup, have been funded through cash on hand during the year ended December 31, 2015.

<u>Cash (Used in) provided by Operations</u>

Operating requirements generated negative cash flow from operations of approximately $6.3 million during the year ended December 31, 2015 and negative cash flow from operations of approximately $3.1 million during the year ended December 31, 2014, versus positive cash flow from operations of approximately $1.7 million for the same period in 2013.

Negative cash flow in 2015 from operations of $6.3 million was significantly affected by operating requirements from Orbital Gas Systems North America and CUI Canada during the year ended December 31, 2015, compared to negative cash flow from operations of $3.1 million for 2014. The change in cash used in operations is primarily the result of the net loss in 2015 before non-cash expenses as well as changes in assets and liabilities.

Significant factors that impacted the cash used in operations included the increased receivables of approximately $3.3 million with $1.4 million of it due to credit sales generated following the opening of Orbital Gas Systems North America and the acquisition of CUI Canada coupled with increased sales volume and the timing of deliveries and related sales terms across the Company. Cash used for inventory purchases increased approximately $3.4 million associated with timing of customer orders and ongoing projects. Additionally, the cash flow from operations was impacted by an approximately $1.1 million increase in prepaid expenses and other current assets associated largely with prepaid insurance premiums, product purchases, royalties and consulting services fees. Also, changes in costs in excess of billings and billings in excess of cost were a combined approximate $2.9 million use of cash in the period related to billings on projects in the Energy segment. The overall use in operating cash was partially offset by an increase in accounts payable of approximately $2.1 million primarily due to the timing of goods receipts and the related terms along with the increase due to the addition of Orbital Gas Systems, North America, Inc. and CUI Canada. Accrued expenses increased $1.9 million related largely to an increase in accrued compensation. Unearned revenue increased $2.2 million primarily in relation to increases in deferred revenue from distributor activity within the power and electro-mechanical segment.

During 2015, CUI Global recorded two significant non-cash entries: $0.2 million for provision for bad debt expense and $0.5 million of deferred income tax benefit.

During 2015 and 2014 and 2013, the Company used stock and options as a form of payment to certain vendors, consultants, directors and employees. For years ended December 31, 2015, 2014 and 2013, the Company recorded a total of $1.3 million, $1.7 million and $0.5 million, respectively for share-based compensation related to equity given, or to be given, to employees, directors and consultants for services provided and as payment for royalties earned. The decrease in 2015 compared to 2014 was due to less stock paid to consultants in 2015 compared to 2014. The increase in 2014 as compared to 2013 is primarily attributable to $0.8 million of stock compensation issued to consultants for strategic consulting services regarding the testing and demonstration of the Energy segment technologies and related strategic customer relations. Additional increases in equity compensation in 2014 are related primarily to the equity compensation expenses associated with director and employee stock grants for performance and vesting expenses associated with options grants.

The 2014 change in cash used by operations is primarily the result of the increased net loss during the year ended December 31, 2014 of $2.8 million of which significant non-cash items impacted profitability. A significant portion of this increased net loss is associated with equity compensation issued in the form of stock and options grants to strategic consultants, employees and directors for performance as well as vesting of granted stock options totaling approximately $1.7 million. Additionally, with the full year amortization of the acquisition related intangible assets acquired with Orbital in 2013, the amortization of intangible assets increased $0.9 million while the deferred income taxes benefit decreased $0.1 million. At the same time as these costs increased, the Company increased revenues $15.4 million and increased gross profits $5.0 million, which contributed to covering operating requirements. Of this increase in revenues, the Energy segment increased approximately $9.5 million related to having Orbital for the full year in 2014 as well as general sales growth for this segment. The Power and Electromechanical segment increased revenues approximately $5.9 million related to continued market penetration through both new and existing customers, including growth within the distribution sales channels.

Further impacting the cash used in operations in 2014 was the significant increase in trade accounts receivables and billings in excess of costs of approximately $3.3 million associated primarily with the increased fourth quarter revenues and the related sales terms on those deliveries. During 2014, the Company experienced an increase of approximately $1.3 million to costs in excess of billings associated with progress on the related projects, increased prepaid expenses of $1.0 million associated primarily with prepaid royalties increases of $0.4 million and increased prepaid taxes of $0.4 million. Unearned revenue increased $0.5 million associated with the timing of related customer orders and the terms granted. Billings in excess decreased $2.9 million during the year related to progress on Energy segment projects.

During 2014, CUI Global recorded two significant non-cash entries, $0.2 million for the unrealized loss on derivative and $0.7 million deferred income taxes benefit.

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The 2013 change in cash provided by operations is primarily the result of the net loss during the year ended December 31, 2013 of $0.9 million of which significant non-cash items impacted profitability. Revenues increased in 2013 both from the addition of Orbital in April 2013, which contributed approximately $17.5 million of revenues during the last three quarters of 2013 and the growth in the Power and Electromechanical segment of CUI, Inc. and CUI Japan, which had increased revenues over the prior year of approximately $2.1 million. The increase in revenues through the Power and Electromechanical segment is associated with growth in revenues through existing customers as well as to new customers, including Future Electronics, which was added as a distribution channel during January 2013. The growth in revenues and related gross profits was offset by the continued expenses to reach new customers, promote new product lines including Novum, and GasPT, increased advertising costs for company products, new product introductions, costs associated with the acquisition and integration of Orbital as well as the overall growth in expenses of the business in relation to the growth in revenues.

Additionally in 2013, a factor that impacted the cash provided by operations included decreased receivables of approximately $1.6 million associated primarily with CUI Inc. and CUI Japan associated with the timing of deliveries and related sales terms. Additionally, the cash flow from operations was impacted by an approximately $1.7 million increase in inventory, which is primarily a function of product held for scheduled customer orders. An increase in prepaid expenses and other current assets largely associated with prepaid license fees for future sales of the GasPT products and prepaid insurance premiums. Further, a payment of $1.8 million was issued toward an accrued obligation for services provided to Orbital. Unearned revenue and billings in excess of costs increased during the period. These are associated with several customer prepayments and deferred revenues including on certain power and electromechanical product sales through distribution.

During 2013, CUI Global recorded three significant non-cash entries - $0.4 million for derivative expense, $0.8 million for deferred income taxes, and $0.5 million impairment of note receivable.

As the Company focuses on technology development, product line additions, integrating CUI Canada operations, and developing Orbital Gas Systems, North America, Inc. during 2016, it will continue to fund research and development together with related sales and marketing efforts for its various product offerings with cash on hand and short term investments held to maturity.

Capital Expenditures and Investments

During the years ended 2015, 2014 and 2013, CUI Global invested $5.1 million, $0.9 million and $2.1 million, respectively, in fixed assets. These investments typically include additions to equipment for engineering and research and development, tooling for manufacturing, furniture, computer equipment for office personnel, facilities improvements and other fixed assets as needed for operations. The 2015 investments in property and equipment included the construction of a new 46,000 square foot state-of-the-art manufacturing/administration/research and development facility in the UK to supplement existing office space at Orbital. The 2013 investments in property and equipment included the down payment toward the September 2013 acquisition of the headquarters facility in Tualatin, Oregon, which is discussed below in Investing Activities – related party activity. The Company anticipates further investment in fixed assets during 2016 in support of its on-going business and continued development of product lines and technologies.

CUI Global invested $0.2 million, $0.2 million, and $0.8 million in other intangible assets during 2015, 2014 and 2013, respectively. These investments typically include product certifications, capitalized website development, software for engineering and research and development and software upgrades for office personnel. In 2013, $0.4 million of the investments are related to the July 2013 acquisition of the exclusive worldwide intellectual property license to the VE probe technology, including both pipeline sampling and thermowell applications. The licenses terms include ongoing minimum royalties during the term of the exclusive agreement. The Company expects its investment in other intangible assets may continue throughout 2015.

During 2015, 2014 and 2013, CUI Global had proceeds from notes receivable of $0, $0, and $33 thousand, respectively.

The Company did not invest in short-term investments classified as held to maturity and received $11.1 million from maturities of these investments during the year ended December 31, 2015. The Company invested $12.8 million in short-term investments classified as held to maturity and received $12.4 million from maturities of these investments during the year ended December 31, 2014. The Company invested $15.4 million in short-term investments classified as held to maturity and received $4.5 million from maturity of these investments during the year ended December 31, 2013. These investments included money market securities, certificates of deposit, commercial paper and corporate notes. Investments made by the Company are subject to an investment policy, which limits our risk of loss exposure by setting appropriate credit quality requirements for investments held, limiting maturities to be one year or less, and also setting appropriate concentration levels to prevent concentrations. This includes a requirement that no more than 3% of the portfolio, or $500,000, whichever is greater, may be invested in one particular issue.

On March 5, 2015, the Company closed on an Asset Purchase Agreement to acquire certain assets and assume certain liabilities of Tectrol, Inc., a Toronto, Canada corporation. The acquisition was effective March 1, 2015 and is included from that date in the Company's Power and Electromechanical segment. As a part of this acquisition strategy, CUI Global, Inc. formed a wholly owned Canadian corporate subsidiary, CUI-Canada, Inc., to receive these acquired assets and liabilities. CUI-Canada, Inc. operations include the design and manufacture assembly of electronic power conversion devices such as AC/DC power supplies, DC/DC power supplies, linear power supplies and uninterruptable power supplies. The purchase price for the acquisition of the assets was $5.2 million subject to good faith adjustments by the parties according to the final value of the non-obsolete inventory conveyed and other closing adjustments. In addition, the agreement calls for an earn-out/royalty payment of two percent of the gross sales (for specific, identified customers) over a period of three years from the closing date, up to a maximum of $0.3 million that may or may not be paid to the seller within 90 days of each calendar year-end, depending on performance by the identified customer(s). The final adjusted purchase price for the acquisition of Tectrol was $4.5 million, which includes the present value of $0.3 million of royalties to be paid on future sales, which was recorded as $0.2 million of contingent consideration.

Effective April 1, 2013, CUI Global closed on a share purchase agreement to acquire 100% of the equity interest in Orbital Gas Systems Limited, a company organized under the laws of England and Wales (‘‘Orbital’’), from Orbital’s sole shareholder. The purchase price for the acquisition of Orbital was £17.0 million British pounds sterling (‘‘£’’), subject to purchase price adjustments, 100% of the purchase price was paid in cash. To secure indemnification obligations, 5.0% of the purchase price, or £850 thousand, was held in escrow through December 1, 2013. The purchase price was $26.2 million, based on the actual exchange rate for British pound sterling to U.S. dollars achieved on April 18, 2013 for the acquisition of Orbital. The cash paid upon acquisition, net of cash received was $17.7 million.

Investing Activities- related party activity

On September 27, 2013, our wholly owned subsidiary, CUI Properties, LLC, signed closing documents on the purchase of our Tualatin, Oregon corporate office real estate. The purchase price for this acquisition was $5.1 million. As part of this transaction, the Company had a third party appraisal performed on the value of the facility acquired to ensure a fair price was obtained in the acquisition. The purchase was funded, in part, by a promissory note payable to Wells Fargo Bank in the amount of $3.7 million with the remaining purchase price being paid from cash on hand.

Financing Activities

See, above, the section entitled Recent Sales of Unregistered Securities for a complete listing of all securities transactions.

During the year ended December 31, 2015, the Company issued payments of $32 thousand against capital leases of motor vehicles and equipment and $0.1 million against the mortgage note payable.

During the year ended December 31, 2014, the Company issued payments of $0.1 million against capital leases of motor vehicles and equipment and $0.1 million against the mortgage note payable.

During the year ended December 31, 2013, the Company received net proceeds after related expenses of $45.1 million from the registered offering sale of 9.7 million shares of common stock at $5.00 per share, made payments of $0.5 million against the line of credit, $2.0 million of payments were made against the related party note payable, $13 thousand of payments against the mortgage note payable and payments of $68 thousand were made against capital leases of motor vehicles and equipment at Orbital. For further discussion of the proceeds from the sale of common stock in 2013, see Note 12. STOCKHOLDERS' EQUITY.

CUI Global may raise additional capital needed to fund the further development and marketing of its products as well as payment of its debt obligations.

Financing activities – related party activity

During 2015, 2014 and 2013, $0.3 million, $0.3 million, and $2.3 million, respectively in principal and interest payments were made in relation to the promissory notes issued to related party, IED, Inc. The 2013 payment utilized $2.0 million from the equity sale proceeds for the repayment of principal. In conjunction with the 2013 principal payment, the promissory note terms were amended to extend the due date to May 15, 2020 and the interest rate was reduced to 5% per annum, with interest payable monthly and the principal due as a balloon payment at maturity.

Please see Note 9. Notes Payable and Note 13. Related Party Transactions for further discussion of these transactions.

Recap of Liquidity and Capital Resources

During the year ended December 31, 2015, the Company invested for future growth with the acquisition of its Canada operations in the Power and Electromechanical segment, the startup of its Houston Orbital operations in the Energy segment along with the investment in the new U.K. Orbital facility. The net cash used in operating activities increased to $6.3 million in 2015 with much of that due to increases in working capital requirements from starting the two new operations during the year and the Company's continued growth.

The Wells Fargo mortgage promissory note has a balance at December 31, 2015 of $3.5 million due, of which $85 thousand is the current portion. The Wells Fargo promissory note has an interest rate of 2% above LIBOR, payable over ten years, secured by a deed of trust on the purchased property executed by CUI Properties, LLC and guaranteed by CUI Global, Inc. In conjunction with the purchase and promissory note, Wells Fargo and the Company entered into a Swap Transaction Confirmation agreement effective October 1, 2013 that effectively maximizes the annual interest rate at 6.27%. As of the date of this filing, the Company is compliant with all covenants on the promissory note with Wells Fargo Bank.

On September 27, 2013, our wholly owned subsidiary, CUI, Inc., closed on a two-year revolving Line of Credit (LOC) with Wells Fargo Bank in the principal amount of $4.0 million. The interest rate on any outstanding balance is 1.75% above either the daily one month LIBOR or the LIBOR in effect on the first day of the applicable fixed rate term. The LOC is secured through a security agreement on accounts receivable and equipment, as well as other miscellaneous personal property assets. CUI Global, Inc., the parent company, is a payment guarantor of the LOC.

As of the date of this filing, the Company is compliant with all covenants on the line of credit with Wells Fargo Capital Finance. At December 31, 2015, there was no balance outstanding on the line of credit.

At December 31, 2015, the Company had cash and cash equivalents balances of $7.3 million. At December 31, 2015 and 2014, the Company had $0.6 million and $2.1 million, respectively, of cash and cash equivalents balances at domestic financial institutions, which were covered under the FDIC insured deposits programs and $0.2 million and $0.1 million, respectively, at foreign financial institutions covered under the United Kingdom Financial Services Compensation (FSC) and the Canada Deposit Insurance Corporation (CDIC). At December 31, 2015 and 2014, the Company held $0.2 million and $64 thousand, respectively, in Japanese foreign bank accounts and $2.2 million and $2.5 million, respectively, in European foreign bank accounts. At December 31, 2015 and 2014, the Company had $0 and $6.8 million, respectively, of investments in certificates of deposit, which were covered under FDIC insured limits and covered under $0.5 million of SIPC insured programs for investments.

The following tables present our contractual obligations as of December 31, 2015 (in thousands)

| | Payments due by period | | | | |
|---|---|---|---|---|---|
| | Less than 1 year | 1 to 3 years | 3 to 5 years | After 5 years | Total |
| Capital Lease Obligations | | | | | |
| Minimum lease payments | $44 | $ 31 | $ - | $ - | $75 |
| Operating lease obligations | | | | | |
| Operating Leases | 565 | 826 | 356 | - | 1,747 |
| Notes payable Maturities | 85 | 183 | 203 | 8,357 | 8,828 |
| Interest on notes payable (1) | 265 | 530 | 365 | - | 1,160 |
| Total Obligations | $959 | $ 1,570 | $ 924 | $ 8,357 | $11,810 |

(1) The interest on notes payable includes fixed interest on the related party note payable to IED, Inc. It does not include the variable interest on the mortgage payable. For further information regarding notes payable see Note 9 - Notes Payable.

As of December 31, 2015 the Company had an accumulated deficit of $88.7 million.

The Company believes its operations and existing financing structure, including cash and working capital line of credit, will provide sufficient cash to meet its short-term working capital requirements for the next twelve months.

The Company expects the revenues from its Power and Electromechanical and Energy segments to help cover operating and other expenses for the next twelve months of operations. Additionally, in March 2015, the Company acquired the assets of Tectrol, Inc., which are included in the operations of the power and electromechanical segment and its product lines will further contribute revenues to help cover operating and other expenses for the next twelve months of operations. If revenues and the funds raised in 2012 and in April 2013 through the sales of equity are not sufficient to cover all operating and other expenses, additional funding may be required. There is no assurance the Company will be able to raise such additional capital. The failure to raise capital or generate product sales in the expected time frame would have a material adverse effect on the Company.

**Off-Balance Sheet Arrangements**

As of December 31, 2015, the Company had no off-balance sheet arrangements.

**Results of Operations**

The following tables set forth, for the periods indicated, certain financial information regarding revenue and costs by segment.

| (dollars in thousands) | For the Year ended December 31, 2015 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Power and Electro - Mechanical | Percent of Segment Revenues | Energy | Percent of Segment Revenues | Other | Percent of Segment Revenues | Total | Percent of Total Revenues |
| | $ | % | $ | % | $ | % | $ | % |
| Total Revenues | $58,464 | 100.0 % | $28,203 | 100.0 % | $- | 0.0 % | $86,667 | 100.0 % |
| Cost of revenue | 36,714 | 62.8 % | 17,661 | 62.6 % | - | 0.0 % | 54,375 | 62.7 % |
| Gross Profit | 21,750 | 37.2 % | 10,542 | 37.4 % | - | 0.0 % | 32,292 | 37.3 % |
| Operating expenses: | | | | | | | | |
| Selling, general and administrative | 16,303 | 27.9 % | 12,091 | 42.9 % | 4,629 | 0.0 % | 33,023 | 38.1 % |
| Depreciation and amortization | 915 | 1.6 % | 1,941 | 6.9 % | 6 | 0.0 % | 2,862 | 3.3 % |
| Research and development | 1,707 | 2.9 % | 141 | 0.5 % | - | 0.0 % | 1,848 | 2.1 % |
| Bad debt | 70 | 0.1 % | 125 | 0.4 % | - | 0.0 % | 195 | 0.2 % |
| Other Operating Expenses | 24 | 0.0 % | 34 | 0.1 % | - | 0.0 % | 58 | 0.1 % |
| Total operating expenses | 19,019 | 32.5 % | 14,332 | 50.8 % | 4,635 | 0.0 % | 37,986 | 43.8 % |
| Income (loss) from operations | $2,731 | 4.7 % | $(3,790 ) | (13.4 %) | $(4,635) | 0.0 % | $(5,694 ) | (6.5 %) |

| (dollars in thousands) | Year ended December 31, 2014 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Power and Electro - Mechanical | Percent of Segment Revenues | Energy | Percent of Segment Revenues | Other | Percent of Segment Revenues | Total | Percent of Total Revenues |

| | $ | % | | $ | % | | $ | % | | $ | % | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Revenues | $48,675 | 100.0 | % | $27,370 | 100.0 | % | $- | 0.0 | % | $76,045 | 100.0 | % |
| Cost of revenue | 29,334 | 60.3 | % | 18,160 | 66.4 | % | - | 0.0 | % | 47,494 | 62.5 | % |
| Gross Profit | 19,341 | 39.7 | % | 9,210 | 33.6 | % | - | 0.0 | % | 28,551 | 37.5 | % |
| Operating expenses: | | | | | | | | | | | | |
| Selling, general and administrative | 13,055 | 26.8 | % | 8,900 | 32.5 | % | 3,969 | 0.0 | % | 25,924 | 34.1 | % |
| Depreciation and amortization | 712 | 1.5 | % | 3,482 | 12.7 | % | 3 | 0.0 | % | 4,197 | 5.5 | % |
| Research and development | 1,169 | 2.4 | % | 137 | 0.5 | % | - | 0.0 | % | 1,306 | 1.7 | % |
| Bad debt | (88 ) | (0.2 | )% | 49 | 0.2 | % | - | 0.0 | % | (39 ) | (0.1 | )% |
| Other operating expenses | 35 | 0.1 | % | 24 | 0.1 | % | - | 0.0 | % | 59 | 0.1 | % |
| Total operating expenses | 14,883 | 30.6 | % | 12,592 | 46.0 | % | 3,972 | 0.0 | % | 31,447 | 41.3 | % |
| Income (loss) from operations | $4,458 | 9.1 | % | $(3,382 ) | (12.4 | )% | $(3,972) | 0.0 | % | $(2,896 ) | (3.8 | )% |

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| (dollars in thousands) | Year ended December 31, 2013 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Power and Electro - Mechanical | Percent of Segment Revenues | Energy | Percent of Segment Revenues | Other | Percent of Segment Revenues | Total | Percent of Total Revenues |
| | $ | % | $ | % | $ | % | $ | % |
| Total Revenues | $42,795 | 100.0 % | $17,857 | 100.0 % | $- | 0.0 % | $60,652 | 100.0 % |
| Cost of revenue | 26,298 | 61.5 % | 10,849 | 60.8 % | - | 0.0 % | 37,147 | 61.2 % |
| Gross Profit | 16,497 | 38.5 % | 7,008 | 39.2 % | - | 0.0 % | 23,505 | 38.8 % |
| Operating expenses: | | | | | | | | |
| Selling, general and administrative | 11,621 | 27.2 % | 4,571 | 25.6 % | 3,254 | 0.0 % | 19,446 | 32.1 % |
| Depreciation and amortization | 596 | 1.4 % | 2,412 | 13.5 % | 3 | 0.0 % | 3,011 | 5.0 % |
| Research and development | 890 | 2.0 % | 53 | 0.3 % | - | 0.0 % | 943 | 1.6 % |
| Bad debt | 159 | 0.4 % | 52 | 0.3 % | - | 0.0 % | 211 | 0.3 % |
| Other operating expenses | 11 | 0.0 % | (1 ) | 0.0 % | - | 0.0 % | 10 | 0.0 % |
| Total operating expenses | 13,277 | 31.0 % | 7,087 | 39.7 % | 3,257 | 0.0 % | 23,621 | 39.0 % |
| Income (loss) from operations | $3,220 | 7.5 % | $(79 ) | (0.5 )% | $(3,257) | 0.0 % | $(116 ) | (0.2 )% |

*Revenue*

| Revenues by Segment (dollars in thousands) | 2015 | Percent Change | 2014 | Percent Change | 2013 |
|---|---|---|---|---|---|
| Power and Electromechanical | $58,464 | 20.1 % | $48,675 | 13.7 % | $42,795 |
| Energy | 28,203 | 3.0 % | 27,370 | 53.3 % | 17,857 |
| Other | - | 0.0 % | - | 0.0 % | - |
| Total revenues | $86,667 | 14.0 % | $76,045 | 25.4 % | $60,652 |

*2015 compared to 2014*

Revenues are attributable to continued sales and marketing efforts, sales through the distribution channel customers, and the addition in March 2015 of CUI Canada related product line, and the revenues generated since the January 2015 opening of Orbital Gas Systems, North America, Inc.

The customer orders related to the power and electromechanical segment are associated with the existing product offering, continued new product introductions, continued sales and marketing programs, new customer engagements, the addition of a third distribution channel, and the addition in March 2015 of the products from CUI Canada.

The Power and Electromechanical segment held a backlog of customer orders of approximately $19.7 million as of December 31, 2015 compared to a backlog of customer orders of approximately $12.5 million as of December 31, 2014. At December 31, 2015, Orbital held a backlog of customer orders of approximately $12.5 million compared to approximately $15.9 million as of December 31, 2014. Not included in Orbital's backlog at December 31, 2015 was the purchase order announced in February 2016 for the sale of 400 of the Company's GasPT Analyzers to Europe's largest natural gas transmission company, which is Orbital's first large-scale order for this product. The Company intends to grow this product line to become a major portion of Orbital's revenue going forward.

CUI, Inc. introduced 838 new products during the year ended 2015 compared to 937 new products during the year ended 2014. The continued product expansion and moving smaller sales through the distribution channel is expected to continue to result in revenue growth in future periods as CUI's sales group and support staff continues to reach new customers, further expand relationships with existing customers and continued product introductions in efforts to have CUI products designed into new projects.

*2014 compared to 2013*

The increase in revenues during 2014 compared to 2013 was attributable to the full year operations of Orbital, which was acquired in April 2013 (Energy segment) and accounted for approximately $9.5 million of the sales increase resulting from sales improvement during the second through fourth quarter periods and owning Orbital for the first quarter of 2014, in addition to increases through the Power and Electromechanical segment of approximately $5.9 million, which was the result of continued product introductions, sales and marketing efforts, further expansion through the distribution sales channel, and the increased back log of CUI orders on hand at December 31, 2013.

The customer orders related to the Power and Electromechanical segment (CUI, Inc. and CUI Japan) were associated with continued product introductions, continued sales and marketing programs, new customer engagements, continued growth within the distribution network of CUI products, and the strengthening within the electronic components industry.

The Power and Electromechanical segment held a backlog of customer orders of approximately $12.5 million as of December 31, 2014 compared to $13.4 million as of December 31, 2013. This decrease is reasonable given the overall growth within the Power and Electromechanical segment. At December 31, 2014, Orbital held a backlog of customer orders of approximately $15.9 million as of December 31, 2014 compared to approximately $25.0 million as of December 31, 2013. The decrease in Orbital backlog was associated with several items, including the increase of approximately $3.3 million for the third and fourth quarter revenues of 2014 in comparison to 2013, and approximately $1.0 million decrease related to the changes in the Sterling Pound versus US Dollar exchange rate. Additionally, Orbital was still being affected by the restructuring of the UK operations of its largest customer related to the ''Revenue = Incentives + Innovation + Outputs'' (RIIO) program and other transformation related initiatives, which significantly impacted that customer's ability to place large contract orders.

CUI, Inc. introduced 937 new products during the year ended 2014 compared to 808 new products during the year ended 2013.

*Cost of Revenue*

| Cost of Revenues by Segment (dollars in thousands) | 2015 | Percent Change | 2014 | Percent Change | 2013 |
|---|---|---|---|---|---|
| Power and Electromechanical | $36,714 | 25.2 % | $29,334 | 11.5 % | $26,298 |
| Energy | 17,661 | (2.7 )% | 18,160 | 67.4 % | 10,849 |
| Other | - | 0.0 % | - | 0.0 % | - |
| Total cost of revenues | $54,375 | 14.5 % | $47,494 | 27.9 % | $37,147 |

*2015 compared to 2014*

The increase to costs of revenue in the Power and Electromechanical Segment during 2015 compared to 2014 is primarily the result of the increase in sales. The decrease in the Energy Segment was due to a better product mix in 2015 compared to 2014 as well as cost reductions associated with bio-methane projects that had increased costs during 2014. As a percentage of revenues, the cost of revenue remained generally consistent at 62.7% compared to 62.5% for 2014. The consolidated cost of revenues was consistent as a percent of revenues due to offsetting factors. The Power and Electromechanical segment had higher costs as a percent of revenues in 2015 due to higher costs as we transitioned manufacturing to our new Canada plant while the Energy segment had lower costs as a percent of revenues due to the improved product mix and cost reductions associated with bio-methane projects.

*2014 compared to 2013*

The significant increase to costs of revenue during 2014 compared to 2013 is primarily the result of the increase in sales in both the Power and Electromechanical Segment and the Energy Segment, which included the operations of Orbital during all of 2014 compared to three quarters of 2013. As a percentage of revenues, the cost of revenue remained generally consistent at 62.5% for 2014 compared to 61.2% in 2013.

*Selling, General and Administrative Expenses*

| Selling, General, and Administrative Expense by Segment (dollars in thousands) | 2015 | Percent Change | 2014 | Percent Change | 2013 |
|---|---|---|---|---|---|
| Power and Electromechanical | $16,303 | 24.9 % | $13,055 | 12.3 % | $11,621 |
| Energy | 12,091 | 35.9 % | 8,900 | 94.7 % | 4,571 |
| Other | 4,629 | 16.6 % | 3,969 | 22.0 % | 3,254 |
| Total SG&A | $33,023 | 27.4 % | $25,924 | 33.3 % | $19,446 |

Selling, General and Administrative (SG&A) expenses includes such items as wages, consulting, general office expenses, business promotion expenses and costs of being a public company including legal and accounting fees, insurance and investor relations.

*2015 compared to 2014*

For year ended December 31, 2015 compared to the same period in 2014, SG&A expenses increased $7.1 million. The increase during 2015 is primarily associated with the addition of the SG&A activities of Orbital Gas Systems, North America, Inc., which opened in Houston, Texas in January 2015 and accounted for approximately $4.0 million of additional SG&A. Partially offsetting this increase in the Energy segment expense was a $0.7 million charge during the third quarter of 2014 of equity compensation expense for strategic consulting services that did not recur in 2015.

In addition, the operations related to CUI Canada, which was acquired in March 2015, accounted for approximately $1.1 million of the increase in SG&A during the period. The remaining increases in SG&A are associated with the ongoing activities to reach new customers, promote our product lines including Novum, GasPT, IRIS and VE-Probe, and new product introductions. As a percentage of total revenue, SG&A increased during 2015 to 38% from 34% during the prior-year comparable period due primarily to the additional costs related to the new operations in Houston and Canada.

The Company anticipates the amount of our sales and marketing expenditures and general and administrative expenses will further increase in 2016 as the Company continues to grow and as we expand our Energy Segment operations. The following are additional factors regarding the anticipated increase in SG&A expenditures for 2016:

- costs associated with the continued efforts to increase revenues;
- costs associated with further expanding distribution sales for the CUI Inc. product lines;
- continued work to penetrate the market with our newer product lines including GasPT, VE, IRIS, Novum; and
- increased costs as we seek to continue to further our technology offerings.

*2014 compared to 2013*

SG&A expenses increased to approximately $25.9 million for the year ended December 31, 2014 from $19.5 million for the same period during 2013. The 2014 increase of approximately $6.5 million from 2013 is primarily the result of having Orbital included for the first quarter of 2014 SG&A activities of Orbital, which accounted for approximately $2.0 million of the increase, stock compensation expense of $1.7 million representing an increase of $1.1 million from 2013 related to stock issuances and vesting expense of options related to consultants for strategic services including customer marketing and investor relations, to directors and employees for services, as well as the overall increase in operations throughout the organization associated with increased revenues of approximately $15.4 million including continued investment in reaching new customers and markets and continuing existing customer relationships.

The total dollar amount of SG&A as a percentage of total revenue for the year ended December 2014 was 34%, compared to 32% in 2013.

*Depreciation and Amortization*

| Depreciation and Amortization (dollars in thousands) | 2015 | Percent Change | 2014 | Percent Change | 2013 |
|---|---|---|---|---|---|
| Power and Electromechanical | $1,258 | 33.7 % | $941 | 8.8 % | $865 |
| Energy | 1,945 | (44.4 )% | 3,498 | 45.1 % | 2,411 |
| Other | 6 | 100.0 % | 3 | 0.0 % | 3 |
| Total depreciation and amortization | $3,209 | (27.8 )% | $4,442 | 35.5 % | $3,279 |

The depreciation and amortization expenses are associated with depreciating buildings, furniture, vehicles, equipment, software and other intangible assets over the estimated useful lives of the related assets.

*2015 compared to 2014*

Depreciation and amortization has decreased in 2015 compared to 2014 as the intangible asset associated with the order backlog acquired with Orbital Gas Systems Limited was fully amortized during the first quarter of 2015.

*2014 compared to 2013*

The large increase in the depreciation and amortization expense between 2014 and 2013 is primarily the result of the increased amortization expense of $0.9 million associated with the identifiable intangible assets that were acquired during the second quarter of 2013 with Orbital and amortized over their estimated useful lives, as well as a full year of depreciation expense for tangible depreciating fixed assets at Orbital in 2014 and a full year of depreciation in 2014 of the CUI Global headquarters building acquired in September 2013.

*Research and Development*

| Research and Development (dollars in thousands) | 2015 | Percent Change | 2014 | Percent Change | 2013 |
|---|---|---|---|---|---|
| Power and Electromechanical | $1,707 | 46.0 % | $1,169 | 31.3 % | $890 |
| Energy | 141 | 2.9 % | 137 | 158.5 % | 53 |
| Other | - | 0.0 % | - | 0.0 % | - |
| Total research and development | $1,848 | 41.5 % | $1,306 | 38.5 % | $943 |

The research and development costs are related to the various technologies for which CUI Global has acquired licensing rights or is developing internally. The expenditures for research and development have been directed primarily towards the further development of Novum Advanced Power technologies including digital POLs, AMT Capacitive Encoders and towards the development of the GasPT and VE technologies. The Company expects that 2016 research and development expenses will be consistent with 2015 as the Company continues to expand its product offering and technologies due to market acceptance and customer integration.

*Impairment Loss*

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset exceeds its fair value and may not be recoverable. In performing the review for recoverability, the future cash flows expected to result from the use of the asset and its eventual disposition are estimated. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized as the excess of the carrying amount over the fair value. Otherwise, an impairment loss is not recognized. Management estimates the fair value and the estimated future cash flows expected. Any changes in these estimates could impact whether there was impairment and the amount of the impairment. There were approximately $4 thousand, $32 thousand, and $0 of impairment expenses recorded by the Company in 2015, 2014, and 2013, respectively.

*Bad Debt*

| Bad Debt Expense (dollars in thousands) | 2015 | Percent Change | 2014 | Percent Change | 2013 |
|---|---|---|---|---|---|
| Power and Electromechanical | $70 | (179.5 )% | $(88) | (155.3 )% | $159 |
| Energy | 125 | 155.1 % | 49 | (5.8 )% | 52 |
| Other | - | 0.0 % | - | 0.0 % | - |
| Total Bad Debt Expense | $195 | (600.0 )% | $(39) | (118.5 )% | $211 |

Bad debt expenses in 2015, 2014 and 2013 represents less than ½% of total revenues and relates to miscellaneous receivables, which the Company has either recorded an allowance for doubtful collections of the receivable or for which the Company has determined the balance to be uncollectible.

*Other Income (expense)*

| | 2015 | Percent Change | 2014 | Percent Change | 2013 |
|---|---|---|---|---|---|
| Foreign exchange gain (loss) | $(391) | 279.6 % | $(103) | (310.2 )% | $49 |
| Earnings from investment | 53 | 8.2 % | 49 | 96.0 % | 25 |
| Interest income | 38 | (73.8 )% | 145 | 26.1 % | 115 |
| Unrealized gain (loss) on derivative | 20 | (111.6 )% | (172) | (59.8 )% | (428) |
| Amortization of investment premiums and discounts | (15 ) | (80.0 )% | (75 ) | 226.1 % | (23 ) |
| Amortization of debt offering costs and debt discount | - | 0.0 % | - | (100.0 )% | (43 ) |
| Other, net | 35 | 6.1 % | 33 | 32.0 % | 25 |
| Total Other income (expense) | $(260) | 111.4 % | $(123) | (56.1 )% | $(280) |

*Impairment on note receivable*

The impairment on note receivable during 2013 is related to fully reserving against the July 1, 2011 note receivable from Comex Electronics and its owners following notification that the primary owner had passed away in December 2013 and the Company intended to seek bankruptcy protection under Japanese law. As of December 31, 2015 recovery is unlikely and the full balance has been written off.

*Investment Income*

The Company recognized investment income on equity investment in an affiliate of approximately $53 thousand in the first 9 months of 2015 and, $49 thousand, and $25 thousand for the years ended December 31, 2014 and 2013, respectively. The Company discontinued the equity method of accounting for its investment as of October 1, 2015. For more information on this investment, see Note 1, Summary of Significant Accounting Policies - Investments, to the Consolidated Financial Statements under Part II, Item 8, ‘‘Financial Statements and Supplementary Data.’’

*Financing Fees*

During 2015 and 2014, the Company did not incur financing fees. During 2013, the Company incurred financing fees associated with the equity raises of approximately $3.2 million. These fees were offset against Additional Paid in Capital in relation to the equity proceeds.

*Change in Value of Warranty Liability*

In 2015, the Company recorded a warranty reserve of $50 thousand at our Canada subsidiary that is included in accrued expenses on the balance sheet at December 31, 2015. During 2014, the Company reduced its warranty liability at Orbital to $0 based upon estimates of future warranty costs associated with 2014 sales. During 2013, following the acquisition of Orbital, the Company reported a warranty liability of approximately $0.2 million, which was included in accrued expenses on the balance sheet at December 31, 2013.

*Non-cash Interest Expense*

The Company recorded expenses of approximately $0 thousand, $0, and $43 thousand during 2015, 2014 and 2013, respectively, for non-cash interest expenses, including amortization of debt offering costs. The decrease in this expense during 2014 is primarily associated with the completion in 2013 of the amortization of the debt offering costs associated with Wells Fargo related debts.

*Interest Expense*

The Company incurred $0.4 million, $0.5 million, and $0.4 million of interest expense during 2015, 2014 and 2013, respectively. Interest expense is for interest on the secured and unsecured convertible notes, secured and unsecured promissory notes, and bank working capital loans and term loans. The decrease in 2015 is due primarily to interest capitalized as part of the construction of the manufacturing/administration/research and development facility in the U.K. for Orbital. The increases in 2014 is the result of the full years interest related to the promissory note payable to Wells Fargo Bank, N.A. for the financing of the purchase of the headquarters facility in Oregon in September 2013, which is discussed further in Item 2. Properties.

*Provision (benefit) for taxes*

*2015 compared to 2014*

A net benefit of $0.4 million was recorded to the income tax provision for the year ended December 31, 2015 resulting in an effective tax rate of 6.4% for the year. Our income tax benefit and effective tax rate were $0.7 million and 20.6%, respectively for the same period in 2014. The income tax benefit in 2015 and 2014 relates primarily to our foreign operations partially offset by state minimum taxes as all other USA tax benefits are reduced by a full valuation allowance.

We continue to record a full valuation allowance against our U.S. net deferred tax assets at December 31, 2015 and 2014 as it is not more likely than not that we will realize a benefit from these assets in a future period. As of December 31, 2015, we have federal and state and foreign net operating loss carry forwards of approximately $49.1 million, $49.3 million, and $0.8 million, respectively, and for which the Federal and state net operating loss carry-forwards will expire between 2018 and 2035.

*2014 compared to 2013*

A net benefit of $0.7 million was recorded to the income tax provision for the year ended December 31, 2014 resulting in an effective tax rate of 20.6% for the year. Our income tax benefit and effective tax rate were $0.4 million and 29.7%, respectively for the same period in 2013. The income tax benefit in 2014 and 2013 related primarily to our foreign operations partially offset by state minimum taxes as all other USA tax benefits are reduced by a full valuation allowance.

Consolidated Net Loss

*2015 compared to 2014*

The Company had a net loss of $6.0 million for the year ended December 31, 2015 compared to a net loss of $2.8 million for the year ended December 31, 2014. The consolidated net loss for 2015 was primarily the result of increased selling, general and administrative expenses related to the opening of the Orbital Gas Systems, North America, Inc. facility in January 2015 and the addition of CUI Canada, Inc. in March 2015 as well as the ongoing amortization of intangible assets related to the Orbital Gas Systems Limited acquisition and CUI Canada acquisition.

*2014 compared to 2013*

The Company had a net loss of $2.8 million for the year ended December 31, 2014 compared to a net loss of $0.9 million for the year ended December 31, 2013. The loss in 2014 was largely attributable to several significant non-cash items that impacted profitability. A significant portion of the increase in non-cash related expense is the equity compensation issued in the form of stock and options grants to strategic consultants, employees and directors for performance as well as vesting of granted stock options totaling approximately $1.7 million, an increase of approximately $1.1 million compared to the year ended December 31, 2013. Additionally, with the full year amortization in 2014 of the acquisition related intangible assets acquired with Orbital in 2013, the amortization of intangible assets increased $0.9 million while the deferred income taxes benefit decreased $0.1 million. At the same time as these costs increased, the Company increased revenues $15.4 million, while the gross profit margin decreased slightly to 37.5% from 38.8%, which helped to offset these increased costs. Of this increase, the Energy segment increased approximately $9.5 million related to having Orbital for the full year in 2014 as well as general sales growth for this segment. The Power and Electromechanical segment increased revenues approximately $5.9 million related to continued market penetration through both new and existing customers, including growth within the distribution sales channels.

The loss in 2013 is largely attributable to the non-cash amortization expense associated with intangible assets acquired with the April 2013 acquisition of Orbital. Total amortization of intangible assets during 2013 was approximately $2.7 million. Additionally, the Company recognized bad debt expense of $0.2 million for miscellaneous customer receivables for which collection was uncertain and $0.5 million for the impairment of note receivable relative to the remaining balance of the note receivable for the divestment of CUI Global's 49% interest in Comex in 2011.

Effect of Inflation and Changing Prices

The Company believes, that during fiscal years ended December 31, 2015, 2014 and 2013, the effect of a hypothetical 100 basis point shift in foreign currency exchange rates applicable to our business would not have had a material impact on our consolidated financial statements.

Recently Adopted and Recently Issued Accounting Standards

Information on recently adopted and recently issued accounting standards is included in Note 2, Summary of Significant Accounting Policies - Recent Accounting Pronouncements, to the Consolidated Financial Statements under Part II, Item 8, ''Financial Statements and Supplementary Data.''

**Item 7A. Quantitative and Qualitative Disclosure about Market Risk**

We are exposed to market risk in the ordinary course of our business. Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. This market risk exposure is primarily a result of fluctuations in foreign currency exchange rates and interest rates. The Company neither holds nor issues financial instruments for trading purposes.

The following sections provide quantitative information on the Company’s exposure to foreign currency exchange rate risk and stock price risk. The Company makes use of sensitivity analyses that are inherently limited in estimating actual losses in fair value that can occur from changes in market conditions.

*Foreign Currency Exchange Rates*

The Company conducts operations in four principal currencies: the U.S. dollar, the British pound sterling the Canadian dollar and the Japanese yen. These currencies operate primarily as the functional currency for the Company’s U.S., U.K. Canadian and Japanese operations, respectively. Cash is managed centrally within each of the four regions with net earnings invested in the U.S. and working capital requirements met from existing U.S. intercompany liquid funds.

Because of fluctuations in currency exchange rates, the Company is subject to currency translation exposure on the results of its operations. Foreign currency translation risk is the risk that exchange rate gains or losses arise from translating foreign entities’ statements of earnings and balance sheets from functional currency to the Company’s reporting currency, the U.S. dollar, for consolidation purposes. As currency exchange rates fluctuate, translation of our Statements of Operations into U.S. dollars affects the comparability of revenues and operating expenses between years.

Revenues and operating expenses are primarily denominated in the currencies of the countries in which our operations are located, the U.S., U.K., Canada and Japan. Our consolidated results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates and may be adversely affected in the future due to changes in foreign exchange rates.

The table below details the percentage of revenues and expenses by the three principal currencies for the fiscal years ended December 31, 2015, December 31, 2014 and December 31, 2013:

| | U.S. Dollars | | British Pound Sterling[1] | | Canadian Dollar (2) | | Japanese Yen | |
|---|---|---|---|---|---|---|---|---|
| Fiscal year ended December 31, 2015 | | | | | | | | |
| Revenues | 70 | % | 28 | % | 1 | % | 1 | % |
| Operating expenses | 66 | % | 27 | % | 6 | % | 1 | % |
| Fiscal year ended December 31, 2014 | | | | | | | | |
| Revenues | 63 | % | 36 | % | 0 | % | 1 | % |
| Operating expenses | 61 | % | 38 | % | 0 | % | 1 | % |
| Fiscal year ended December 31, 2013 | | | | | | | | |
| Revenues | 69 | % | 29 | % | 0 | % | 2 | % |
| Operating expenses | 71 | % | 28 | % | 0 | % | 1 | % |

[1] On April 18, 2013, we closed on our share purchase agreement to acquire 100% of the equity interest in Orbital Gas Systems Limited, which was effective April 1, 2013.

[2] On March 5, 2015, the Company closed on an asset purchase agreement to acquire the assets of Tectrol, Inc. (CUI Canada) which was effective March 1, 2015.

To date, we have not entered into any hedging arrangements with respect to foreign currency risk and have limited activity with forward foreign currency contracts or other similar derivative instruments. The Company believes, that during fiscal ended December 31, 2015, the effect of a hypothetical 100 basis point shift in foreign currency exchange rates applicable to our business would not have had a material impact on our consolidated financial statements.

*Investment Risk*

The Company has an Investment Policy that, *inter alia* , provides an internal control structure that takes into consideration safety (credit risk and interest rate risk), liquidity and yield. Our Investment officers, CEO and CFO, oversee the investment portfolio and compiles a quarterly analysis of the investment portfolio.

Cash and cash equivalents are diversified and maintained with several financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions of reputable credit, therefore, bear minimal credit risk.

The Company has trade receivable and revenues concentrations with large customers, which include a large concentration of trade receivables and revenues in the United Kingdom.

**Item 8. Financial Statements and Supplementary Data**

**CUI Global, Inc.**

**Index to Consolidated Financial Statements**

**Contents**

**Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders

CUI Global Inc.

Tualatin, Oregon

We have audited the accompanying consolidated balance sheets of CUI Global, Inc. and Subsidiaries as of December 31, 2015 and 2014 and the related consolidated statements of operations, comprehensive income and (loss), changes in stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of CUI Global, Inc. and Subsidiaries as of December 31, 2015 and 2014, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), CUI Global Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Our audit excluded an evaluation of internal control over financial reporting of CUI-Canada, Inc., which was established in connection with the acquisition of the assets, certain liabilities, and operations of Tectrol, Inc. by CUI Global, Inc. in 2015. Our report dated March 14, 2016 expressed an adverse opinion due to material weaknesses regarding management's failure to design and maintain controls surrounding: 1) the recognition of revenue on a percentage of completion basis under generally accepted accounting principles in the United States of America; and 2) the preparation and review of foreign income taxes within the Company's consolidated income tax provision. These weaknesses are described in management's assessment, Management's Annual Report on Internal Control Over Financial Reporting.

/s/ Perkins & Company, P.C.

Portland, Oregon

March 14, 2016

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of CUI Global, Inc.:

We have audited the accompanying consolidated statement of operations, comprehensive income and loss, stockholders' equity and cash flows of CUI Global, Inc. and Subsidiaries ("the Company") for the year ended December 31, 2013. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the consolidated results of its operations and its cash flows of CUI Global, Inc. and Subsidiaries for the year ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America.

/s/ *Liggett & Webb, P.A.*

LIGGETT & WEBB, P.A.

*Certified Public Accountants*

Boynton Beach, Florida

March 31, 2014, except for Notes 4, 6 and 15 as to which
the date is May 13, 2014 and Note 15 which the date is March 16, 2015.

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**CUI Global, Inc.**

**Consolidated Balance Sheets**

**As of December 31, 2015 and 2014**

| (in thousands except share and per share data) | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Assets: | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 7,267 | $ 11,704 |
| Short-term investments held to maturity | - | 11,160 |
| Trade accounts receivable, net of allowance of $90 and $254, respectively | 14,685 | 9,980 |
| Inventories, net of allowance of $386 and $394, respectively | 12,075 | 6,841 |
| Costs in excess of billings | 1,571 | 1,889 |
| Prepaid expenses and other | 2,559 | 1,552 |
| Total current assets | 38,157 | 43,126 |
| | | |
| Property and equipment, less accumulated depreciation of $3,126 and $2,877 respectively | 11,950 | 7,793 |
| Goodwill | 21,527 | 21,887 |
| Other intangible assets, less accumulated amortization of $8,999 and $6,987, respectively | 18,746 | 19,785 |
| Investment | 385 | 332 |
| Deposits and other assets | 83 | 131 |
| | | |
| Total assets | $ 90,848 | $ 93,054 |
| | | |
| Liabilities and Stockholders' Equity: | | |
| Current Liabilities: | | |
| Accounts payable | $ 5,806 | $ 3,834 |
| Mortgage note payable, current portion | 85 | 81 |
| Capital lease obligation, current portion | 41 | 33 |
| Accrued expenses | 5,222 | 3,161 |
| Billings in excess of costs | 2,190 | 3,624 |
| Unearned revenue | 3,711 | 1,622 |
| Total current liabilities | 17,055 | 12,355 |
| | | |
| Long term mortgage note payable, less current portion | 3,439 | 3,523 |
| Long term note payable, related party | 5,304 | 5,304 |
| Capital lease obligation, less current portion | 29 | 74 |
| Derivative liability | 580 | 600 |
| Deferred tax liabilities, net | 4,533 | 5,096 |

| | | |
|---|---|---|
| Other long-term liabilities | 392 | 132 |
| Total liabilities | 31,332 | 27,084 |
| | | |
| Commitments and contingencies | | |
| | | |
| Stockholders' Equity: | | |
| Common stock, par value $0.001; 325,000,000 shares authorized; 20,806,219 shares issued and outstanding at December 31, 2015 and 20,747,740 shares issued and outstanding at December 31, 2014 | 21 | 21 |
| Additional paid-in capital | 149,639 | 148,398 |
| Accumulated deficit | (88,704) | (82,717) |
| Accumulated other comprehensive income (loss) | (1,440) | 268 |
| Total stockholders' equity | 59,516 | 65,970 |
| Total liabilities and stockholders' equity | $ 90,848 | $ 93,054 |

See accompanying notes to consolidated financial statements

**CUI Global, Inc.**

**Consolidated Statements of Operations**

**For the Years Ended December 31, 2015, 2014 and 2013**

(In thousands, except share and per share amounts)

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| Total revenues | $86,667 | $76,045 | $60,652 |
| Cost of revenues | 54,375 | 47,494 | 37,147 |
| Gross profit | 32,292 | 28,551 | 23,505 |
| Operating expenses: | | | |
| Selling, general and administrative | 33,023 | 25,924 | 19,446 |
| Depreciation and amortization | 2,862 | 4,197 | 3,011 |
| Research and development | 1,848 | 1,306 | 943 |
| Provision for (Credit to) Bad Debt | 195 | (39) | 211 |
| Other operating expenses | 58 | 59 | 10 |
| Total operating expenses | 37,986 | 31,447 | 23,621 |
| Loss from operations | (5,694) | (2,896) | (116) |
| Impairment on note receivable | - | - | (502) |
| Other income (expense) | (260) | (123) | (280) |
| Interest expense | (441) | (508) | (443) |
| Loss before taxes | (6,395) | (3,527) | (1,341) |
| Income tax benefit | (408) | (726) | (398) |
| Net loss | $(5,987) | $(2,801) | $(943) |
| Basic and diluted weighted average common and common equivalent shares outstanding | 20,792,494 | 20,658,634 | 17,751,042 |
| Basic and diluted (loss) per common share | $(0.29) | $(0.14) | $(0.05) |

See accompanying notes to consolidated financial statements

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**CUI Global, Inc.**

**Consolidated Statements of Comprehensive Income and (Loss)**

**For the Years Ended December 31, 2015, 2014 and 2013**

(In thousands)

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| Net loss | $(5,987) | $(2,801) | $(943 ) |
| Other comprehensive income (loss) | | | |
| Foreign currency translation adjustment | (1,708) | (1,570) | 1,862 |
| Comprehensive income (loss) | $(7,695) | $(4,371) | $919 |

See accompanying notes to consolidated financial statements

**CUI Global, Inc.**

**Consolidated Statements of Changes in Stockholders' Equity**

**For the Years Ended December 31, 2015, 2014 and 2013**

(In thousands, except share amounts)

| | Common Stock | | Additional | Accumulated | Accumulated Other Comprehensive | Total Stockholders' |
|---|---|---|---|---|---|---|
| | Shares | Amount | Paid-in Capital | Deficit | Income (Loss) | Equity |
| Balance, December 31, 2012 | 10,883,280 | $ 11 | $ 100,948 | $ (78,973 ) | $ (24 ) | $ 21,962 |
| Options granted for services and compensation | - | - | 410 | - | - | 410 |
| Issuance of common stock | 9,660,000 | 10 | 45,125 | - | - | 45,135 |
| | 23,383 | - | 132 | - | - | 132 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Common stock issued for compensation, services and royalty payments | | | | | | |
| Net loss for the year ended Decmeber 31, 2013 | | | | (943 ) | - | (943 ) |
| Other comprehensive income | | | | - | 1,862 | 1,862 |
| Balance, December 31, 2013 | 20,566,663 | 21 | 146,615 | (79,916 ) | 1,838 | 68,558 |
| Options granted for services and compensation | - | - | 712 | - | - | 712 |
| Common stock issued for exercises of options | 31,850 | - | - | - | - | - |
| Common stock issued for compensation, services and royalty payments | 142,745 | - | 1,032 | - | - | 1,032 |
| Common stock issued for accrued expenses and accrued royalties | 6,482 | - | 39 | - | - | 39 |
| Net loss for the year ended Decmeber 31, 2014 | - | - | - | (2,801 ) | - | (2,801 ) |
| Other comprehensive loss | - | - | - | - | (1,570 ) | (1,570 ) |
| Balance, December 31, 2014 | 20,747,740 | 21 | 148,398 | (82,717 ) | 268 | 65,970 |
| Options granted for services and compensation | - | - | 478 | - | - | 478 |
| Common stock issued for exercises of options | 122 | - | - | - | - | - |
| Common stock issued and to be issued for compensation, services, and royalty payments | 58,357 | - | 763 | - | - | 763 |
| Net loss for the year ended December 31, 2015 | - | - | - | (5,987 ) | - | (5,987 ) |
| Other comprehensive loss | - | - | - | - | (1,708 ) | (1,708 ) |
| Balance, December 31, 2015 | 20,806,219 | $ 21 | $ 149,639 | $ (88,704 ) | $ (1,440 ) | $ 59,516 |

See accompanying notes to consolidated financial statements

**CUI Global, Inc.**

**Consolidated Statements of Cash Flows**

**For the Years Ended December 31, 2015, 2014 and 2013**

(in thousands)

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net loss | $(5,987) | $(2,801) | $(943) |
| Adjustments to reconcile net (loss) to net cash provided by (used in) operating activities: | | | |
| Depreciation | 854 | 786 | 555 |
| Amortization of intangibles | 2,355 | 3,656 | 2,724 |
| Amortization of investment premiums and discounts | 15 | 75 | 23 |
| Non-cash interest expense, including amortization of debt offering costs | - | - | 43 |
| Stock and options issued for compensation, royalties and services | 1,267 | 1,686 | 542 |
| Unrealized (Gain) loss on derivative | (20) | 172 | 428 |
| Non-cash earnings on equity method investment | (53) | (49) | (25) |
| Provision for (credit to) bad debt expense and returns allowances | 192 | (91) | 302 |
| Deferred income taxes | (534) | (674) | (816) |
| Impairment of intangible assets | 4 | 32 | - |
| Inventory reserve | (3) | (148) | (28) |
| Impairment of note receivable | - | - | 502 |
| Loss on disposal of assets | 54 | 26 | 10 |
| Other, net | (5) | - | - |
| (Increase) decrease in operating assets: | | | |
| Trade accounts receivable | (3,323) | (1,378) | 1,628 |
| Inventory | (3,365) | 210 | (1,733) |
| Costs in excess of billings | (1,612) | (1,347) | (177) |
| Prepaid expenses and other assets | (1,102) | (971) | (229) |
| Deposits and other assets | 68 | 19 | (14) |
| Increase (decrease) in operating liabilities: | | | |
| Accounts payable | 2,126 | (257) | (7) |
| Accrued expenses | 1,913 | 353 | (2,544) |
| Unearned revenue | 2,204 | 505 | 837 |
| Billings in excess of costs | (1,307) | (2,938) | 598 |
| NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES | (6,259) | (3,134) | 1,676 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Acquisition of a business, net of contingent consideration (Note 4) | (4,285) | - | (17,710) |

| | | | |
|---|---|---|---|
| Deposits for property and equipment | - | (62 ) | - |
| Purchase of property and equipment | (5,137 ) | (942 ) | (2,137 ) |
| Proceeds from sale of property and equipment | 17 | - | - |
| Investments in other intangible assets | (178 ) | (158 ) | (801 ) |
| Purchase of short term investments held to maturity | - | (12,767) | (15,390) |
| Maturities of short term investments held to maturity | 11,145 | 12,401 | 4,499 |
| Proceeds from notes receivable | - | - | 33 |
| Receipts from deferred property grant | 425 | - | - |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | 1,987 | (1,528 ) | (31,506) |
| | | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Payments on capital lease obligations | (32 ) | (108 ) | (68 ) |
| Payments on notes and loans payable | (81 ) | (77 ) | (13 ) |
| Proceeds from sales of common stock and exercise of options, net of offering costs | - | - | 45,135 |
| Payments on notes payable, related party | - | - | (2,000 ) |
| Payments on demand notes payable | - | - | (459 ) |
| NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES | (113 ) | (185 ) | 42,595 |
| | | | |
| Effect of exchange rate changes on cash | (52 ) | (25 ) | 771 |
| Net (decrease) increase in cash and cash equivalents | (4,437 ) | (4,872 ) | 13,536 |
| Cash and cash equivalents at beginning of year | 11,704 | 16,576 | 3,040 |
| | | | |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | $7,267 | $11,704 | $16,576 |

| | | | |
|---|---|---|---|
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | | |
| Income taxes paid | $44 | $374 | $426 |
| Interest paid, net of capitalized interest | $440 | $509 | $425 |
| | | | |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES: | | | |
| Deposits for property and equipment purchases in accounts payable at December 31 | $- | $62 | $- |
| Common stock issued for royalties payable pursuant to product agreements, related party | $22 | $13 | $25 |
| Contingent consideration recorded in acquisition | $216 | $- | $- |
| Capital leases | $- | $75 | $76 |
| Conversion of accrued liabilities to common stock | $- | $39 | $- |
| Common stock issued and to be issued for consulting services and compensation in common stock | $741 | $1,019 | $107 |
| Mortgage note payable assumed for the acquisition of real estate | $- | $- | $3,694 |

See accompanying notes to consolidated financial statements

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**CUI Global, Inc.**

**Notes to Consolidated Financial Statements**

## 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

CUI Global Inc. (CUI Global) is a platform company composed of two segments, Power and Electromechanical segment and the Energy segment.

The Power and Electromechanical segment is made up of the following wholly owned subsidiaries of CUI Global: CUI, Inc. (CUI), based in Tualatin, Oregon; CUI Japan, based in Tokyo, Japan; and CUI Canada, based in Toronto, Canada. All three subsidiaries are providers of electromechanical components including power supplies, transformers, converters, connectors and industrial controls for Original Equipment Manufacturers (OEMs).

The Power and Electromechanical segment defines its product offerings into two categories: **components** including connectors, speakers, buzzers, test and measurement devices, and control solutions including encoders and sensors; and **power solutions**, which includes Novum. These offerings provide a technology architecture that addresses power and related accessories to industries as broadly ranging as consumer electronics, medical and defense.

The Company's Energy segment is made up of the Orbital Gas Systems Limited subsidiary (Orbital) and the Orbital Gas Systems, North America, Inc. subsidiary. This business segment was formed when in April 2013, CUI Global acquired 100% of the capital stock of Orbital, a United Kingdom-based provider of natural gas infrastructure and advanced technology, including metering, odorization, remote telemetry units (''RTU'') and a diverse range of personalized gas engineering solutions to the gas utilities, power generation, emissions, manufacturing and automotive industries. In January 2015, CUI Global formed and opened Orbital Gas Systems, North America, Inc. a wholly owned subsidiary, to represent the Energy segment in the North American market. The GasPT® technology products are sold through Orbital.

During the year ended December 31, 2015, total revenues at CUI Global consisted of 67% from the Power and Electromechanical segment and 33% from the Energy segment.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include estimates used to review the Company's goodwill, impairments and estimations of long-lived assets, revenue recognition on percentage of completion type contracts, allowances for uncollectible accounts, inventory valuation, warranty reserves, valuations of non-cash capital stock issuances and the valuation allowance on deferred tax assets. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable in the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Principles of Consolidation

The consolidated financial statements for 2015 and 2014 include the accounts of CUI Global, Inc. and its wholly owned subsidiaries CUI, Inc., CUI Japan, CUI Canada (included since March 1, 2015), CUI Properties, LLC, Orbital Gas Systems, Ltd. (included since April 1, 2013), and Orbital Gas Systems, North America, Inc. (included since January 1, 2015) hereafter referred to as the ''Company.'' Significant intercompany accounts and transactions have been eliminated in consolidation.

Fair Value of Financial Instruments

Accounting Standards Codification (''ASC'') 820 ''Fair Value Measurements and Disclosures'' (''ASC 820'') defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles in the U.S., and enhances disclosures about fair value measurements. ASC 820 describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value, which are the following:

- Level 1 – Pricing inputs are quoted prices available in active markets for identical assets or liabilities as of the reporting date.
- Level 2 – Pricing inputs are quoted for similar assets, or inputs that are observable, either directly or indirectly, for substantially the full term through corroboration with observable market data. Level 2 includes assets or liabilities valued at quoted prices adjusted for legal or contractual restrictions specific to these investments.
- Level 3 – Pricing inputs are unobservable for the assets or liabilities; that is, the inputs reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability.

Management believes the carrying amounts of the short-term financial instruments, including cash and cash equivalents, accounts receivable, costs in excess of billings, prepaid expense and other assets, accounts payable, accrued liabilities, billings in excess of costs, unearned revenue, and other liabilities reflected in the accompanying balance sheet approximate fair value at December 31, 2015 and 2014 due to the relatively short-term nature of these instruments. Mortgage debt and related notes payable approximate fair value based on current market conditions. The Company measures its derivative liability on a recurring basis using significant observable inputs (Level 2). The Company's derivative liability is valued using a LIBOR swap curve.

Cash and Cash Equivalents

Cash includes deposits at financial institutions with maturities of three months or less. The Company at times has cash in banks in excess of FDIC insurance limits and places its temporary cash investments with high credit quality financial institutions. The Company considers all highly liquid marketable securities with original maturities of 90 days or less at the date of acquisition to be cash equivalents. Cash equivalents include money market funds, certificates of deposit and commercial paper. At December 31, 2015 and 2014, the Company had $0.6 million and $2.1 million, respectively, of cash and cash equivalents balances at domestic financial institutions, which were covered under the FDIC insured deposits programs and $0.2 million and $0.1 million, respectively, at foreign financial institutions covered under the United Kingdom Financial Services Compensation (FSC) and the Canada Deposit Insurance Corporation (CDIC). At December 31, 2015 and 2014, the Company held $0.2 million and $64 thousand, respectively, in Japanese foreign bank accounts and $2.2 million and $2.5 million, respectively, in European foreign bank accounts and $0.3 million and zero, respectively, in Canadian bank accounts.

Investments

The Company considers all marketable investments with original maturities over 90 days that mature in less than one year from the balance sheet date to be short-term investments. Short-term investments primarily include money market funds, certificates of deposit, corporate notes, and commercial paper. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using a method that approximates the effective interest method. Under this method, dividend and interest income are recognized when earned. At December 31, 2015 and 2014, CUI Global had $0 and $11.2 million, respectively, of short-term investments classified as held-to-maturity, which are reported at amortized cost, which approximates market. At December 31, 2015 and 2014, the Company had $0 and $6.8 million, respectively of investments in certificates of deposit, which were covered under FDIC insured limits and covered under $500,000 of SIPC insured programs for investments.

Through the acquisition of CUI, Inc. the Company obtained 352,589 common shares (representing an 11.54% interest from December 31, 2012 to June 30, 2013, 8.62% through December 31, 2013, 8.94% through March 31, 2014, and 8.5% thereafter) in Test Products International, Inc. ("TPI"). TPI is a provider of handheld test and measurement equipment. Through September 30, 2015, the investment in TPI was treated under the equity method, whereby investments are carried at cost, plus or minus the Company's proportionate share, based on present ownership interests of: (a) the investee's profit or loss after the date of acquisition; (b) changes in the Company's equity that have not been recognized in the investee's profit or loss; and (c) certain other adjustments. Through September 30, 2015 CUI Global enjoyed a close association with TPI through common related parties, IED, Inc. and James McKenzie as well as through participation that allowed for a significant amount of influence over TPI's business decisions. Accordingly, through September 30, 2015, for financial statement purposes, the Company recognized its investment in TPI under the equity method.

Subsequent to September 30, 2015, CUI Global and its common related parties have been unable to obtain a timely financial report, which is inconsistent with prior periods, evidencing a reduction in the influence of CUI Global and the common related parties over TPI. Based on this change in influence, and CUI Global's level of technical control through its 8.5% equity interest, management has determined that effective with the quarter ended December 31, 2015 that CUI Global no longer has significant influence over TPI and accordingly, the investment in TPI should be accounted for under the cost method. As of December 31, 2015, the carrying amount of CUI Global's cost method investment in TPI is $385 thousand. CUI Global reviewed this cost method investment for impairment as of December 31, 2015 and concluded that no impairment was necessary.

Presented below are the balance sheets for the equity method treatment of this investment as of December 31, 2014 and 2013 and the equity method earnings through nine months of 2015 and for the years ended December 31, 2014 and 2013 for the periods that CUI Global had significant influence over TPI:

| | As of December 31, | |
|---|---|---|
| (in thousands) | 2014 | 2013 |
| Current assets | $ 6,300 | $ 6,224 |
| Non-current assets | 430 | 256 |
| Total Assets | $ 6,730 | $ 6,480 |
| | | |
| Current liabilities | $ 1,974 | $ 2,276 |
| Non-current liabilities | 770 | 687 |
| Stockholders' equity | 3,986 | 3,517 |
| Total Liabilities and Stockholders' Equity | $ 6,730 | $ 6,480 |

| | For the Nine Months Ended September 30, | For the Years Ended December 31, | |
|---|---|---|---|
| (in thousands) | 2015 | 2014 | 2013 |
| Revenues | $ 10,718 | $ 14,468 | $ 13,779 |
| Operating income | 674 | 872 | 1,049 |
| Net profit | 621 | 767 | 299 |
| Other comprehensive profit (loss): | | | |
| Foreign currency translation adjustment | - | - | 34 |
| Comprehensive net profit | $ 621 | $ 767 | $ 333 |
| Company share of Net Profit | $ 53 | $ 49 | $ 25 |

<u>Accounts Receivable and Allowance for Uncollectible Accounts</u>

Accounts receivable consist of the receivables associated with revenue derived from product sales including present amounts due to contracts accounted for under percentage of completion method. An allowance for uncollectible accounts is recorded to allow for any amounts that may not be recoverable, based on an analysis of prior collection experience, customer credit worthiness and current economic trends. Based on management's review of accounts receivable, an allowance for doubtful accounts of $0.1 million and $0.3 million at December 31, 2015 and 2014, respectively, is considered adequate. The reserve in both periods takes into account aged receivables that management believes should be specifically reserved for as well as historic experience with bad debts to determine the total reserve appropriate for each period. Receivables are determined to be past due based on the payment terms of original invoices. The Company grants credit to its customers, with standard terms of Net 30 days. The Company routinely assesses the financial strength of its customers and, therefore, believes that its accounts receivable credit risk exposure is limited. Additionally, the Company maintains a foreign credit receivables insurance policy that covers many of the CUI, Inc. foreign customer receivable balances in effort to further reduce credit risk exposure.

Inventory

Inventories consist of finished and un-finished products and are stated at the lower of cost or market through either the first-in, first-out (FIFO) method as a cost flow convention or through the moving average cost method.

At December 31, 2015, and 2014, inventory is presented on the balance sheet net of reserves. The Company provides reserves for inventories estimated to be excess, obsolete or unmarketable. The Company's estimation process for assessing the net realizable value is based upon its known backlog, projected future demand, historical usage and expected market conditions. Manufactured inventory includes material, labor and overhead. Inventory by category at December 31, 2015 and December 31, 2014 consists of (in thousands):

| | December 31, 2015 | December 31, 2014 |
|---|---|---|
| Finished goods | 8,278 | 5,610 |
| Raw materials | $ 3,294 | $ 1,625 |
| Work-in -process | 889 | - |
| Inventory reserves | (386 ) | (394 ) |
| Total inventories | $ 12,075 | $ 6,841 |

Land, Buildings, Improvements, Furniture, Vehicles, Equipment, and Leasehold Improvements

Land is recorded at cost and includes expenditures made to ready it for use. Land is considered to have an infinite useful life.

Buildings and improvements are recorded at cost and are depreciated over their estimated useful lives.

Furniture, vehicles, and equipment are recorded at cost and include major expenditures, which increase productivity or substantially increase useful lives.

Leasehold improvements are recorded at cost and are depreciated over the lesser of the lease term, estimated useful life, or ten years.

The cost of buildings, improvements, furniture, vehicles, and equipment is depreciated over the estimated useful lives of the related assets.

Depreciation is computed using the straight-line method for financial reporting purposes. The estimated useful lives for land, buildings, improvements, furniture, vehicles, and equipment are as follows:

| | Estimated Useful Life |
|---|---|
| Buildings and improvements | 5 to 39 years |
| Furniture and equipment | 3 to 10 years |
| Vehicles | 3 to 5 years |

Maintenance, repairs and minor replacements are charged to expenses when incurred. When furniture, vehicles and equipment are sold or otherwise disposed of, the asset and related accumulated depreciation are removed from this account, and any gain or loss is included in the statement of operations.

Long-Lived Assets

Long-lived assets including finite-lived identifiable assets are periodically reviewed for impairment whenever circumstances and situations change such that there is an indication that the carrying amounts may not be recoverable. In performing the review for recoverability, the future cash flows expected to result from the use of the asset and its eventual disposition are estimated. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the long -lived asset, an impairment loss is recognized as the excess of the carrying amount over the fair value. Otherwise, an impairment loss is not recognized. Management estimates the fair value and the estimated future cash flows expected. Any changes in these estimates could impact whether there was impairment and the amount of the impairment.

Identifiable Intangible Assets

Intangible assets are stated at cost net of accumulated amortization and impairment. The fair value for intangible assets acquired through acquisitions is measured at the time of acquisition utilizing the following inputs, as needed:

1. Inputs used to measure fair value are unadjusted quote prices available in active markets for the identical assets or liabilities if available.

2. Inputs used to measure fair value, other than quoted prices included in 1, are either directly or indirectly observable as of the reporting date through correlation with market data, including quoted prices for similar assets and liabilities in active markets and quoted prices in inactive markets. This includes assets and liabilities valued using models or other pricing methodologies that do not require significant judgment since the input assumptions used in

the models, such as interest rates and volatility factors, are corroborated by readily observable data from actively quoted markets for substantially the full life of the asset.

3. Inputs used to measure fair value are unobservable inputs supported by little or no market activity and reflect the use of significant management judgment. These values are generally determined using pricing models for which the assumptions utilize management's estimates of market participant assumptions.

4. Expert appraisal and fair value measurement as completed by third party experts.

The following are the estimated useful life for the intangible assets:

| | Estimated Useful Life |
|---|---|
| Finite-lived intangible assets | |
| Order backlog | 2 years |
| Trade name - Orbital | 10 years |
| Trade name - V-Infinity | 5 years |
| Trade name - CUI Canada | 3 years |
| Customer list – Orbital | 10 years |
| Customer list – CUI Canada | 7 years |
| Technology rights | 20 years (1) |
| Technology-Based Asset - Know How | 12 years |
| Technology-Based Asset - Software | 10 years |
| Technology-Based Asset - Power | 7 years |
| Software | 3 to 5 years (2) |
| Patents | See endnote (3) |
| Other intangible assets | See endnote (4) |
| | |
| Indefinite-lived intangible assets | |
| Trade name – CUI | See endnote (5) |
| Customer list – CUI | See endnote (5) |
| Patents pending technology | See endnote (5) |

(1) Technology rights are amortized over a 20-year life or the term of the rights agreement.

(2) Software assets are recorded at cost and include major expenditures, which increase productivity or substantially increase useful lives.

(3) Patents are amortized over the life of the patent. Any patents not approved will be expensed at that time.

(4) Other intangible assets are amortized over an appropriate useful life, as determined by management in relation to the other intangible asset characteristics.

(5) Indefinite-lived intangible assets are reviewed annually for impairment and when circumstances suggest.

Indefinite-Lived Intangibles and Goodwill Assets

The Company accounts for business combinations under the acquisition method of accounting in accordance with ASC 805, ‘‘Business Combinations,’’ where the total purchase price is allocated to the tangible and identified intangible assets acquired and liabilities assumed based on their estimated fair values. The purchase price is allocated using the information currently available, and may be adjusted, up to one year from acquisition date, after obtaining more information regarding, among other things, asset valuations, liabilities assumed and revisions to preliminary estimates. The purchase price in excess of the fair value of the tangible and identified intangible assets acquired less liabilities assumed is recognized as goodwill.

The Company tests for indefinite-lived intangibles and goodwill impairment in the second quarter of each year and whenever events or circumstances indicate that the carrying amount of the asset exceeds its fair value and may not be recoverable. The Company’s qualitative assessment of impairment for indefinite-lived assets at May 31, 2015, followed the guidance in ASC 350-30-35-18A and 18B. In accordance with its policies, the Company performed a qualitative assessment of indefinite-lived intangibles and goodwill at May 31, 2015, and determined there was no impairment of indefinite-lived intangibles and goodwill.

CUI Global has adopted ASU 2011-08, which simplifies how an entity is required to test goodwill for impairment. The ASU allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under this ASU, CUI Global is not required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The ASU includes a number of factors to consider in conducting the qualitative assessment. We adopted ASU 2011-08 during the year ended December 31, 2013. The adoption of ASU 2011-08 did not have an impact on our consolidated financial statements. The Company tests for goodwill impairment in the second quarter of each year and whenever events or changes in circumstances indicate that the carrying amount of the asset exceeds its fair value and may not be recoverable.

As detailed in ASC 350-20-35-3A, in performing its testing for goodwill, management completes a qualitative analysis to determine whether it was more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. To complete this review, management follows the steps in ASC 350-20-35-3C to evaluate the fair values of the intangibles and goodwill and considers all known events and circumstances that might trigger an impairment of goodwill. In 2013, 2014 and 2015, the analysis, determined that there was no impairment necessary to goodwill. Through these reviews, management concluded that there were no events or circumstances that triggered an impairment (and there was no expectation that a reporting unit or a significant portion of a reporting unit would be sold or otherwise disposed of in the following year), therefore, no further analysis was necessary to prepare for goodwill impairment beyond the steps in 350-20-35-3C in accordance with ASU 2011-08.

Patent Costs

The Company estimates the patents it has filed have a future beneficial value; therefore it capitalizes the costs associated with filing for its patents. At the time the patent is approved, the patent costs associated with the patent are amortized over the useful life of the patent. If the patent is not approved, at that time the costs will be expensed.

Accrued expenses

Accrued expenses are liabilities that reflect expenses on the statement of operations that have not been paid or recorded in accounts payable at the end of the period. At December 31, 2015 and December 31, 2014, accrued expenses of $5.6 million and $3.2 million, respectively, included $1.7 million and $1.2 million, respectively, of accrued inventory payable.

Derivative instruments

The Company uses various derivative instruments including forward currency contracts, and interest rate swaps to manage certain exposures. These instruments are entered into under the Company's corporate risk management policy to minimize exposure and are not for speculative trading purposes. The Company recognizes all derivatives as either assets or liabilities in the consolidated balance sheet and measures those instruments at fair value. Changes in the fair value of derivatives are recognized in earnings. The Company has limited involvement with derivative instruments and does not trade them. From time to time, the Company may enter into foreign currency exchange contracts to minimize the risk associated with foreign currency exchange rate exposure from expected future cash flows. The Company has entered into one interest rate swap, which has a maturity date of ten years from the date of inception, and is used to minimize the interest rate risk on the variable rate mortgage. During the years ended December 31, 2015, 2014 and 2013, the Company had an unrealized gain of $20 thousand and unrealized losses of approximately $172 thousand and $428 thousand, respectively, related to the derivative liabilities.

Derivative Liabilities

The Company evaluates embedded conversion features pursuant to FASB Accounting Standards Codification No. 815 (''FASB ASC 815''), ''Derivatives and Hedging,'' which requires a periodic valuation of the fair value of derivative instruments and a corresponding recognition of liabilities associated with such derivatives.

Stock-Based Compensation

The Company records its stock-based compensation expense under our stock option plans and also issues stock for services. The Company accounts for stock-based compensation using FASB Accounting Standards Codification No. 718 (''FASB ASC 718''), ''Compensation – Stock Compensation.'' FASB Codification No. 718 requires the fair value of all stock-based employee compensation awarded to employees to be recorded as an expense over the related vesting period. Employee stock compensation is recorded at fair value using the Black-Scholes Pricing Model. The underlying assumptions used in the Black-Scholes Pricing Model by the Company are taken from publicly available sources including: (1) volatility, which is calculated using historic stock price information from online finance websites such as Google Finance and Yahoo Finance; (2) the stock price on the date of grant is obtained from online finance websites such as those previously noted; (3) the appropriate discount rates are obtained from the United States Federal Reserve economic research; and (4) data website and other inputs are determined based on previous experience and related estimates. With regards to expected volatility, the Company utilizes an appropriate period for historical share prices for CUI Global that best reflect the expected volatility for determining the fair value of our stock options. Due to the significant changes to the Company, including the 2013 equity raise, acquisition of Orbital, increased institutional ownership and other such factors that have impacted volatility, the volatility period utilized for

2014 option grant valuations used a historical period to January 1, 2013. The Company may change its expected volatility factor to include a longer historical periods as the Company has remained consistent with regards to the aforementioned factors.

See Note 12 for additional disclosure and discussion of the employee stock plan and activity.

Common stock, stock options and common stock warrants issued to other than employees or directors are recorded on the basis of their fair value, as required by FASB ASC 505, which is measured as of the date required by FASB ASC 505, ‘‘Equity – Based Payments to Non-Employees.’’ In accordance with FASB ASC 505, the stock options or common stock warrants are valued using the Black-Scholes option pricing model on the basis of the market price of the underlying common stock on the ‘‘valuation date,’’ which for options and warrants related to contracts that have substantial disincentives to non-performance is the date of the contract, and for all other contracts is the performance completion date. Expense related to the options and warrants is recognized on a straight-line basis over the shorter of the period over which services are to be received or the vesting period. Where expense must be recognized prior to a valuation date, the expense is computed based off an estimate of the fair value of the stock award as valued under the Black-Scholes option pricing model on the basis of the market price of the underlying common stock at the end of the period, and any subsequent changes in the market price of the underlying common stock up through the valuation date is reflected in the expense recorded in the subsequent period in which that change occurs.

Common stock issued to other than employees or directors subject to performance (performance based awards) require interpretation to include ASC 505-50-30-13 as to when the counterparty’s performance is complete based on delivery, or other relevant performance criteria in accordance with the relevant agreement. When performance is complete, the common stock should be issued and the expense recorded on the basis of their value as required by FASB ASC 505 on the date the performance requirement is achieved.

Defined Contribution Plans

The Company has a 401(k) retirement savings plan that allows employees to contribute to the plan after they have completed two months of service and are 21 years of age. The Company matches the employee's contribution up to 6% of total compensation. CUI, Inc. made total employer contributions, net of forfeitures, of $0.4 million, $0.3 million, and $0.2 million for 2015, 2014 and 2013, respectively.

Orbital operates a defined contribution retirement benefit plan for employees who have been employed with the company at least 12 months and who chose to enroll in the plan. Orbital contributes to its plan the equivalent of 5% of the employee's salary and the employee has the option to contribute pre-tax earnings. Orbital made total employer contributions of $0.3 million during 2015, $0.3 million during 2014 and $0.1 million during the year of acquisition from April 1, 2013 through December 31, 2013.

Revenue Recognition

*Power and Electromechanical segment*

Product revenue is recognized in the period when persuasive evidence of an arrangement with a customer exists, the products are shipped and title has transferred to the customer, the price is fixed or determinable, and collection is reasonably assured. The Company sells to distributors pursuant to distribution agreements that have certain terms and conditions such as the right of return and price protection, which inhibit revenue recognition unless they can be reasonably estimated as we cannot assert the price is fixed and determinable and estimate returns. For one distributor that comprises 20% of consolidated revenue, we have such history and ability to estimate and therefore recognize revenue upon sale to the distributor and record a corresponding reserve for the estimated returns. For two different distributor arrangements that together represents 7% of consolidated revenue, we do not have sufficient history to reasonably estimate price protection reserve and the right of return and accordingly defer revenue and the related costs until such time as the distributor resells the product.

*Energy segment*

For Production-type contracts meeting the Company's minimum threshold, revenues and related costs on these contracts are recognized using the ''percentage of completion method'' of accounting in accordance with ASC 605-35, *Accounting for Performance of Construction-Type and Certain Production Type Contracts* (''ASC 605-35''). Under this method, contract revenues and related expenses are recognized over the performance period of the contract in direct proportion to the costs incurred as a percentage of total estimated costs for the entirety of the contract. Costs include direct material, direct labor, subcontract labor and any allocable indirect costs. The Company captures certain job costs as work progresses, including labor, material and costs not invoiced. Margin adjustments are made as information pertaining to contracts changes. All un-allocable indirect costs and corporate general and administrative costs are charged to the periods as incurred. The amount of costs not invoiced is captured to ensure an estimated margin consistent with that expected at the completion of the project. In the event a loss on a contract is foreseen, the Company recognizes the loss when it is determined. Contract costs plus recognized profits are accumulated as deferred assets, and billings and/or cash received are recorded to a deferred revenue liability account. The net of these two accounts for any individual project is presented as ''Costs in excess of billings,'' an asset account, or ''Billings in excess of costs,'' a liability account. At December 31, 2015, the Costs in excess of billings balance was $1.6 million and the Billings in excess of costs balance was approximately $2.2 million.

Production type contracts that do not qualify for use of the percentage of completion method are accounted for using the ''completed contract method'' of accounting in accordance with ASC 605-35-25-57. Under this method, contract costs are accumulated as deferred assets, and billings and/or cash received is recorded to a deferred revenue liability account, during the periods of construction, but no revenues, costs, or profits are recognized in operations until the period within which completion of the contract occurs. A contract is considered complete when all costs except insignificant items have been incurred; the equipment is operating according to specifications and has been accepted by the customer.

For product sales in the Energy segment, revenue is recognized in the period when persuasive evidence of an arrangement with a customer exists, the products are shipped and title has transferred to the customer, the price is fixed or determinable, and collection is reasonably assured.

Revenues from warranty and maintenance activities are recognized ratably over the term of the warranty and maintenance period and the unrecognized portion is recorded as deferred revenue.

Shipping and Handling Costs

Amounts billed to customers in sales transactions related to shipping and handling represent revenues earned for the goods provided and are included in sales, and were approximately $48 thousand, $42 thousand, and $41 thousand, respectively, for the years ended December 31, 2015, 2014 and 2013, respectively. The Company expenses inbound shipping and handling costs as cost of revenues.

Warranty Reserves

A warranty reserve liability is recorded based on estimates of future costs on sales recognized. At December 31, 2015, the balance of approximately $50 thousand for warranty reserve liability is included in accrued expenses on the balance sheet. At December 31, 2014, there was no warranty reserve recorded based on these estimates.

Advertising

The costs incurred for producing and communicating advertising are charged to operations as incurred. Advertising expense for the years ended December 31, 2015, 2014 and 2013 were $1.4 million, $1.3 million, and $1.1 million, respectively. In addition to these advertising costs, the Company also incurs advertising related costs for advertising completed in partnership with our distributors. These costs are offset against revenues. During 2015, 2014 and 2013, the advertising costs offset against revenues were $0.4 million, $0.3 million, and $0.3 million, respectively.

Income Taxes

Income taxes are accounted for under the asset and liability method of FASB Accounting Standards Codification No. 740 (‘‘FASB ASC 740’’), ‘‘Income Taxes.’’ Under FASB ASC 740, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income in the period that includes the enactment date. Deferred tax assets are reduced by a valuation allowance to the extent that management believes it is more likely than not that such deferred tax assets will not be realized.

Valuation allowances have been established against domestic based deferred tax assets due to uncertainties in the Company’s ability to generate sufficient taxable income in future periods to make realization of such assets more likely than not. In future periods, tax benefits and related domestic deferred tax assets will be recognized when management considers realization of such amounts to be more likely than not. The Company has not provided for valuation allowances on deferred tax assets in any other jurisdiction.

The Company recognizes interest and penalties, if any, related to its tax positions in income tax expense. There was $0 and $0.3 million of income tax receivable at December 31, 2015 and 2014 primarily related to foreign prepayments, refunds and carryback.

The Company files consolidated income tax returns for federal and many state jurisdictions in addition to separate subsidiary income tax returns in Japan, the United Kingdom and Canada. As of December 31, 2015, the Company is not under examination by any income tax jurisdiction. The Company is no longer subject to examination for years prior to 2012.

Net Loss per Share

In accordance with FASB Accounting Standards Codification No. 260 (''FASB ASC 260''), ''Earnings per Share,'' basic net loss per share is computed by dividing the net loss available to common stockholders for the period by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted average number of diluted shares outstanding during the period calculated using the treasury stock method. Due to the Company's net loss in 2015, 2014 and 2013, the assumed exercise of stock options using the treasury stock method would have had an antidilutive effect and therefore all options for the three years were excluded from the calculation of diluted net loss per share for each of the three years. Accordingly, diluted net loss per share is the same as basic net loss per share for 2015, 2014 and 2013. The weighted average shares outstanding included 61,548 and 1,302 of shares that are considered outstanding, but unissued as of December 31, 2015 and 2014, respectively, for shares to be issued in accordance with a royalty agreement pertaining to sales of the GasPT devices in 2015 and 2014, unpaid equity share bonuses and unpaid director compensation in 2015.

The following table summarizes the number of stock options outstanding excluding amounts applicable to contingent conversion option at December 31, 2015, 2014 and 2013, which may dilute future earnings per share.

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| Options, outstanding | 970,847 | 998,432 | 1,030,807 |

Any common shares issued as a result of stock options or warrants would come from newly issued common shares, from our remaining authorized shares.

The following is the calculation of basic and diluted earnings per share for the three years ended December 31, 2015, 2014, and 2013.

(in thousands except dollars per share)

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| Net loss | $(5,987 ) | $(2,801 ) | $(943 ) |
| Basic and diluted weighted average number of shares outstanding | 20,792 | 20,659 | 17,751 |
| Basic loss per common share | $(0.29 ) | $(0.14 ) | $(0.05 ) |
| Diluted loss per common share | $(0.29 ) | $(0.14 ) | $(0.05 ) |

Foreign Currency Translation

The financial statements of the Company's foreign offices have been translated into U.S. dollars in accordance with FASB ASC 830, ‘‘Foreign Currency Matters’’ (FASB ASC 830). All balance sheet accounts have been translated using the exchange rate in effect at the balance sheet date. Statement of Operations amounts have been translated using an appropriately weighted average exchange rate for the year. The translation gains and losses resulting from the changes in exchange rates during 2015, 2014 and 2013 have been reported in accumulated other comprehensive income (loss), except for gains and losses resulting from the translation of intercompany receivables and payables, which are included in earnings for the period.

Segment Reporting

In accordance with ASC 280-10, operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The measurement basis of segment profit or loss is income (loss) from operations.

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Operating segments are defined in accordance with ASC 280-10 as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. Management has identified six operating segments based on the activities of the Company in accordance with the ASC 280-10. These operating segments have been aggregated into three reportable segments. The three reportable segments are Power and Electromechanical, Energy and Other. The Power and Electromechanical segment is focused on the operations of CUI, Inc., CUI-Canada, Inc. and CUI Japan for the sale of internal and external power supplies and related components, industrial controls and test and measurement devices. The Energy segment is focused on the operations of Orbital Gas Systems Limited and Orbital Gas Systems, North America, Inc. which includes gas related test and measurement systems, including the GasPT. The Other segment represents the remaining activities that are not included as part of the other reportable segments and represent primarily corporate activity.

The following information represents segment activity as of and for the year ended December 31, 2015:

| (in thousands) | Power and Electro-Mechanical | Energy | Other | Total |
|---|---|---|---|---|
| Revenues from external customers | $ 58,464 | $ 28,203 | $ - | $ 86,667 |
| Depreciation and amortization(1) | 1,259 | 1,944 | 6 | 3,209 |
| Earnings on equity method investment | 53 | - | - | 53 |
| Interest expense | 226 | 4 | 211 | 441 |
| Income (loss) from operations | 2,731 | (3,790 ) | (4,635) | (5,694 ) |
| Segment assets | 51,600 | 37,029 | 2,219 | 90,848 |
| Other intangibles assets, net | 9,577 | 9,167 | 2 | 18,746 |
| Goodwill | 13,077 | 8,450 | - | 21,527 |
| Expenditures for segment assets (4) | 920 | 4,395 | - | 5,315 |

The following information represents segment activity as of and for the year ended December 31, 2014:

| (in thousands) | Power and Electro-Mechanical | Energy | Other | Total |
|---|---|---|---|---|
| Revenues from external customers | $ 48,675 | $ 27,370 | $ - | $ 76,045 |
| Depreciation and amortization (1) | 941 | 3,498 | 3 | 4,442 |
| Earnings on equity method investment | 49 | - | - | 49 |
| Interest expense | 232 | 11 | 265 | 508 |
| Income (loss) from operations | 4,458 | (3,382 ) | (3,972 ) | (2,896 ) |
| Segment assets | 44,127 | 35,010 | 13,917 | 93,054 |
| Other intangibles assets, net (3) | 8,482 | 11,295 | 8 | 19,785 |
| Goodwill | 13,021 | 8,866 | - | 21,887 |

| | | | | |
|---|---|---|---|---|
| Expenditures for segment assets [4] | 905 | 257 | - | 1,162 |

The following information represents segment activity as of and for the year ended December 31, 2013:

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| (in thousands) | Power and Electro-Mechanical | Energy | Other | Total |
|---|---|---|---|---|
| Revenues from external customers | $ 42,795 | $17,857 | $- | $60,652 |
| Depreciation and amortization [1] | 865 | 2,411 | 3 | 3,279 |
| Earnings on equity method investment | 25 | - | - | 25 |
| Interest expense | 114 | 6 | 323 | 443 |
| Income (loss) from operations [2] | 3,220 | (79 ) | (3,257 ) | (116 ) |
| Segment assets | 40,446 | 42,127 | 16,587 | 99,160 |
| Other intangibles assets, net [3] | 8,814 | 15,162 | 11 | 23,987 |
| Goodwill | 13,037 | 9,412 | - | 22,449 |
| Expenditures for segment assets [4] | 2,003 | 935 | - | 2,938 |

(1) For the years ended December 31, 2015, 2014 and 2013, depreciation and amortization totals included $0.3 million, $0.2 million and $0.3 million, respectively that were classified as cost of revenues in the Consolidated Statements of Operations.

(2) Power and Electromechanical income from operations includes the effect of $0.2 million of depreciation previously allocated to the Other segment.

(3) Includes $0.4 million and $0.5 million, respectively at December 31, 2014 and 2013, of software and product certifications that were reclassified from property and equipment.

(4) Includes purchases of property, plant and equipment and the investment in other intangible assets. Excludes amounts for the CUI – Canada, Inc. acquisition in 2015 and the Orbital acquisition in 2013.

The following information represents revenue by country for the years ended December 31, 2015, 2014 and 2013:

| | For the Year Ended December 31 | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | 2014 | | 2013 | |
| (in thousands) | Amount | % | Amount | % | Amount | % |
| USA | $47,068 | 54 % | $37,051 | 49 % | $33,073 | 55 % |
| United Kingdom | 21,407 | 25 % | 25,921 | 34 % | 16,562 | 27 % |
| China | 4,950 | 6 % | 4,980 | 6 % | 4,410 | 7 % |
| All Others | 13,242 | 15 % | 8,093 | 11 % | 6,607 | 11 % |
| Total | $86,667 | 100% | $76,045 | 100% | $60,652 | 100% |

The following information represents long-lived assets (excluding deferred tax assets) by country as of December 31, 2015, 2014 and 2013.

(in thousands)

| | 2015 | 2014 |
|---|---|---|
| USA | $27,400 | $27,671 |
| United Kingdom | 23,006 | 22,144 |
| Other | 2,261 | 113 |
| | $52,667 | $49,928 |

Reclassification

Certain amounts from the prior periods have been reclassified to the current period presentation including, at December 31, 2014, $1.9 million of trade accounts receivable that were reclassified to costs in excess of billings, along with the related cash flow effect, $0.3 million of product certifications, net of amortization that were reclassified to Other intangible assets, net and $88 thousand of software, net of amortization that was reclassified to Other intangible assets, net on the condensed consolidated balance sheets. For the years ended December 31, 2014 and 2013, $0.1 million and $52 thousand, respectively were reclassified from selling, general and administrative expense to research and development expense. For the year ended December 31, 2014 and 2013 condensed consolidated statements of cash flows, $0.2 million and $0.2 million, respectively, was reclassified to amortization of intangibles from depreciation and $0.2 million and $0.4 million, respectively, was reclassified to investment in other intangible assets from acquisitions of property and equipment as a result of the product certification and software reclassifications.

Recent Accounting Pronouncements

In February 2016, The FASB issued Accounting Standards Update (''ASU'') No. 2016-02, *Leases (Topic 842)* (''ASU 2016-02''). ASU 2016-02 requires lessees to present right-of-use assets and lease liabilities (with the exception of short-term leases) on the balance sheet. The new guidance will be effective for public business entities for fiscal years beginning after December 15, 2018 including interim periods within that fiscal year. We are currently evaluating the impact of the Company's pending adoption of ASU 2016-02 on the Company's consolidated financial statements and will adopt the standard in 2019.

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes* (''ASU 2015-17''). ASU 2015-17 requires deferred tax liabilities and assets to be classified as noncurrent in the consolidated financial statements instead of separating deferred taxes into current and noncurrent amounts. ASU 2015-17 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016, and early adoption is permitted. The Company adopted the provisions of ASU 2015-17 in 2015. ASU 2015-17 requires that all deferred tax assets and liabilities be classified as noncurrent on the balance sheet. In accordance with ASU 2015-17, the Company's balance sheet at December 31, 2014 required no reclassification as all deferred tax assets and liabilities were classified as noncurrent on the balance sheet.

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, "*Revenue from Contracts with Customers*" ("ASU 2014-09"), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The standard was originally effective for annual periods beginning after December 15, 2016, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional note disclosures). On July 9, 2015, the FASB affirmed its proposal to defer the effective date of the new revenue standard for public entities by one year to annual reporting periods beginning after December 15, 2017, and interim periods beginning in the first interim period within the year of adoption. Early application is permitted, but not before the original effective date for public entities, annual reporting periods after December 15, 2016, and interim periods beginning in the first interim period within the year of adoption. We are currently evaluating the impact of the Company's pending adoption of ASU 2014-09 on the Company's consolidated financial statements and have not yet determined the method by which the Company will adopt the standard in 2017.

In June 2014, the FASB issued ASU No. 2014-12, "*Compensation – Stock Compensation* (Topic 718) – Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period" ("ASU 2014-12"). The amendments in ASU 2014-12 require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718, Compensation – Stock Compensation, as it relates to awards with performance conditions that affect vesting to account for such awards. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. The standard is effective for annual periods and interim period within those annual periods beginning after December 15, 2015, and early adoption is permitted. The adoption of this provision is not expected to have an impact on the Company's financial condition or results of operations.

In January 2015, the FASB issued ASU No. 2015-01, "*Income Statement – Extraordinary and Unusual Items (Subtopic 225-20) - Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*" ("ASU 2015-01"). ASU 2015-01 eliminates from U.S. GAAP the concept of extraordinary items. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The adoption of this provision is not expected to have an impact on the Company's financial condition or results of operations.

In July 2015, the FASB issued ASU No. 2015-11, "*Simplifying the Measurement of Inventory*" ("ASU 2015-11") that requires entities to measure inventory at the lower of cost or net realizable value. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The guidance is effective for fiscal years beginning after December 15, 2016 and interim periods within fiscal years beginning after December 15, 2017. The guidance must be applied on a prospective basis with early adoption permitted. The guidance is not expected to have a material impact on our financial statements and we have not elected to early adopt.

## 3. INVESTMENTS AND FAIR VALUE MEASUREMENTS

The Company's fair value hierarchy for its cash equivalents, marketable securities and derivative instruments as of December 31, 2015 and December 31, 2014, respectively, was as follows (in thousands):

| December 31, 2015 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Money market securities | $1,915 | $- | $- | $1,915 |
| Total assets | $1,915 | $- | $- | $1,915 |
| Derivative instrument payable | $- | $580 | $- | $580 |
| Contingent consideration | - | - | 216 | 216 |
| Total liabilities | $- | $580 | $216 | $796 |

| December 31, 2014 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Money market securities | $1,281 | $- | $ - | $1,281 |
| Certificates of deposit | 6,845 | - | - | 6,845 |
| Commercial paper | - | 2,249 | - | 2,249 |
| Corporate notes | - | 2,815 | - | 2,815 |
| Total assets | $8,126 | $5,064 | $ - | $13,190 |
| Derivative instrument payable | $- | $600 | $ - | $600 |
| Total liabilities | $- | $600 | $ - | $600 |

There were no transfers between Level 3 and Level 2 in 2015 as determined at the end of the reporting period. The contingent consideration liability is associated with the acquisition of Tectrol in March 2015 and represents the present value of the expected future contingent payment based on revenue projections of select Tectrol legacy products. The inputs used to measure contingent consideration are classified as Level 3 within the valuation hierarchy. The valuation is not supported by market criteria and reflects the Company's internal revenue forecasts. Since the valuation is not supported by market criteria, the valuation is completely dependent on unobservable inputs. During quarterly updates of the valuation, the calculation of the value is based on actual and reasonably estimated future revenues. Based on the Company's fourth quarter 2015 analysis, the Company did not adjust the current value of the contingent consideration based on updated revenue projections.

## 4. ACQUISITIONS

CUI-Canada, Inc.

On March 5, 2015, the Company closed on an Asset Purchase Agreement to acquire certain assets and assume certain liabilities of Tectrol, Inc., a Toronto, Canada corporation. The acquisition was effective March 1, 2015 and is included from that date in the Company's Power and Electromechanical segment. As a part of this acquisition strategy, CUI Global, Inc. formed a wholly owned Canadian corporate subsidiary, CUI-Canada, Inc., to receive these acquired assets and liabilities. That entity entered into a five-year lease of the Toronto facility where Tectrol, Inc. was operating its business. CUI-Canada, Inc. operations include the design and manufacture assembly of electronic power conversion devices such as AC/DC power supplies, DC/DC power supplies, linear power supplies and uninterruptable power supplies.

The purchase price for the acquisition of the assets was $5.2 million subject to good faith adjustments by the parties according to the final value of the non-obsolete inventory conveyed and other closing adjustments. In addition, the agreement calls for an earn-out/royalty payment of two percent of the gross sales (for specific, identified customers) over a period of three years from the closing date, up to a maximum of $0.3 million that may or may not be paid to the seller within 90 days of each calendar year-end, depending on performance by the identified customer(s). The final adjusted purchase price for the acquisition of Tectrol was $4.5 million, which includes the present value of $0.3 million of royalties to be paid on future sales, which was recorded as $0.2 million of contingent consideration. At December 31, 2015, $60 thousand of contingent consideration is included on the balance sheet in accrued expenses and the remainder is included in other long-term liabilities. The full purchase price less the contingent consideration was paid in cash. The Company funded the consideration paid to the shareholder of Tectrol with existing cash and cash equivalents and funds from short-term investments that had matured.

The acquisition was accounted for using the acquisition method of accounting and the purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition.

The allocation of the purchase price is as follows:

| (in thousands) | |
|---|---|
| Purchase price | $4,501 |
| | |
| Inventory | $2,302 |
| Property and equipment | 831 |
| Software | 73 |
| Intangible, customer lists | 270 |
| Intangible, trademark and tradename | 130 |
| Intangible, technology-based asset | 1,000 |
| Goodwill | 64 |
| Liabilities assumed | (169 ) |
| | $4,501 |

The table below summarizes the condensed pro forma information of the results of operations of the Company, for the year ended December 31, 2015 and 2014 as though the acquisition had been completed as of January 1, 2014 and January 1, 2015 (in thousands):

For the year ended December 31, 2015

| | CUI Global, Inc. | Tectrol, Inc. | Adjustment (1) | Pro forma |
|---|---|---|---|---|
| Gross revenue | $ 86,667 | $ 4,837 | $ - | $ 91,504 |
| Total expenses | 92,654 | 5,212 | 31 | 97,897 |
| Net income (loss) | $ (5,987 ) | $ (375 ) | | $ (6,393 ) |

For the year ended December 31, 2014

| | CUI Global, Inc. | Tectrol, Inc. | Adjustment (1) | Pro forma |
|---|---|---|---|---|
| Gross revenue | $ 76,045 | $ 16,494 | $ - | $ 92,539 |
| Total expenses | 78,846 | 17,804 | 186 | 96,836 |
| Net income (loss) | $ (2,801 ) | $ (1,310 ) | | $ (4,297 ) |

(1) Adjustment to recognize the estimated depreciation and amortization expense for each of the presented periods assuming amortization of the intangible assets and depreciation of tangible assets over their estimated useful lives. Estimated depreciation and amortization for the unaudited pro forma condensed consolidated statements of operations are $31 thousand and $0.2 million for 2015 and 2014, respectively.

The above unaudited condensed pro forma information does not purport to represent what the Companies' combined results of operations would have been if such transactions had occurred at the beginning of the period presented, and are not indicative of future results.

Orbital Gas Systems Limited

Effective April 1, 2013, CUI Global closed on a share purchase agreement to acquire 100% of the equity interest in Orbital Gas Systems Limited, a company organized under the laws of England and Wales (‘‘Orbital’’), from Orbital's sole shareholder. The purchase price for the acquisition of Orbital was £17,000,000 British pounds sterling (‘‘£’’), ($26,205,500), subject to purchase price adjustments, 100% of the purchase price was paid in cash. To secure indemnification obligation, 5.0% of the purchase price, or £850,000, was held in escrow through December 1, 2013.

We funded the consideration paid to the shareholder of Orbital with a portion of the net proceeds received from a public offering of our $0.001 par value common stock that was registered on an SEC Form S-1 registration statement declared effective by the SEC on April 11, 2013. Subsequent to closing on this acquisition, Orbital Gas Systems, Ltd. became a wholly owned subsidiary of CUI Global, Inc.

The acquisition was accounted for using the acquisition method of accounting and the purchase price was allocated to the assets acquired and liabilities assumed based upon their estimated fair values at the date of acquisition.

The allocation of the purchase price is as follows:

| (in thousands) | |
|---|---|
| Purchase price | $26,206 |
| | |
| Cash and cash equivalents | $8,496 |
| Trade accouns receivable | 5,597 |
| Unbilled accounts receivable | 66 |
| Inventory | 445 |
| Costs in excess of billings | 351 |
| Other current assets | 21 |
| Property and equipment | 1,563 |
| Intangible, customer lists | 7,180 |
| Intangible, order backlog | 3,434 |
| Intangible, trade name | 1,847 |
| Intangible, technology-based asset know how | 2,909 |
| Intangible, technology-based asset software | 631 |
| Goodwill | 8,800 |
| Liabilities assumed | (11,419) |
| Deferred tax liability | (3,715) |
| | $26,206 |

Key factors that make up the goodwill created by the transaction include knowledge and experience of the acquired workforce and infrastructure and expected synergies from the combination of operations as it pertains to the Energy segment of CUI Global.

The table below summarizes the unaudited condensed pro forma information of the results of operations of CUI Global, Inc. for the years ended December 31, 2013 and 2012 as though the acquisition had been completed as of January 1, 2013 and 2012:

For the year ended December 31, 2013

| | CUI Global, Inc. | Orbital Gas Systems Ltd. | | Adjustment | Pro forma |
|---|---|---|---|---|---|
| Gross revenue | $ 60,652 | $ 4,569 | | $ - | $ 65,221 |
| Total expenses | 61,595 | 5,384 | (1) | 588 | 67,567 |
| Net income (loss) | $ (943) | $ (815) | | | $ (2,346) |

For the year ended December 31, 2012

| | CUI Global, Inc. | Orbital Gas Systems Ltd. | | Adjustment | Pro forma |
|---|---|---|---|---|---|
| Gross revenue | $ 41,085 | $ 23,017 | (2) | $ 2,370 | $ 66,472 |
| Total expenses | 43,611 | 18,965 | (3) | 4,848 | 67,424 |
| Net income (loss) | $ (2,526) | $ 4,052 | | | $ (952) |

(1) Adjustment to recognize the amortization expense of $0.7 million of acquisition related intangible assets and the provision for tax benefit of $0.1 million associated with the deferred tax liability as though the acquisition had occurred at the beginning of the period.

(2) Adjustment to recognize US GAAP adjustments for percentage of completion revenues of $2.4 million completed during the period.

(3) Adjustment for US GAAP recognition of $2.4 million of cost of revenues on percentage of completion revenues recognized under US GAAP, $3.0 million of amortization of acquisition related intangible assets, and provision for tax benefit of $0.6 million associated with the deferred tax liability as though the acquisition had occurred at the beginning of the period and $85 thousand for US GAAP adjustment for accrued compensation.

The above unaudited condensed pro forma information does not purport to represent what the Companies' combined results of operations would have been if such transactions had occurred at the beginning of the periods presented, and are not indicative of future results.

**5. PROPERTY AND EQUIPMENT, NET**

Property and equipment is summarized as follows at December 31, 2015 and 2014 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Land | $1,244 | $1,266 |
| Buildings and improvements | 8,868 | 5,395 |
| Equipment | 4,595 | 3,777 |
| Computers | 369 | 232 |
| | 15,076 | 10,670 |
| Less accumulated depreciation | (3,126 ) | (2,877 ) |
| | $11,950 | $7,793 |

Depreciation expense for the years ended December 31, 2015, 2014 and 2013 was $0.9 million, $0.8 million, and $0.6 million, respectively.

During 2015, the Company opened a new facility in the United Kingdom, acquired assets in Toronto, Canada and started up our Orbital Gas Systems, North America, Inc. business, which increased total property and equipment. During the year ended December 31, 2015, the Company disposed of $0.6 million of property and equipment with an accumulated depreciation at disposal of $0.6 million and a recognized loss on disposal of $54 thousand. During the year ended December 31, 2014, the Company disposed of $1.0 million of property and equipment with an accumulated depreciation at disposal of $1.0 million and recognized a loss on disposal of $26 thousand.

**6. GOODWILL AND OTHER INTANGIBLE ASSETS**

At December 31, 2015 and 2014, the gross carrying amount and accumulated amortization of intangible assets, other than goodwill, are as follows:

| (in thousands) | *Estimated Useful Life | December 31, 2015 Gross Carrying Amount | Accumulated Amortization | Identifiable Intangible Assets, less Accumulated Amortization | December 31, 2014 Gross Carrying Amount | Accumulated Amortization | Identifiable Intangible Assets, less Accumulated Amortization |
|---|---|---|---|---|---|---|---|
| Finite-lived intangible assets | | | | | | | |
| Power and Electro-Mechanical Segment | | | | | | | |
| Trademark and tradename - V-Infinity | 5 years | $ 1,095 | $ (767 ) | $ 328 | $ 1,095 | $ (548 ) | $ 547 |
| Trademark and tradename - AMP Group | 3 years | 27 | (4 ) | 23 | - | - | - |
| Trademark and tradename - CUI Canada | 3 years | 128 | (36 ) | 92 | - | - | - |
| Technology rights | 20 years** | 1,241 | (251 ) | 990 | 265 | (124 ) | 141 |
| Computer software | 3 to 5 years | 972 | (780 ) | 192 | 813 | (724 ) | 89 |
| Product certifications | 3 years | 825 | (439 ) | 386 | 626 | (277 ) | 349 |
| Customer relationships - CUI Canada | 7 years | 267 | (32 ) | 235 | - | - | - |
| Other intangible assets | *** | 121 | (92 ) | 29 | 141 | (87 ) | 54 |
| Total Power and Electro-Mechanical | | 4,676 | (2,401 ) | 2,275 | 2,940 | (1,760 ) | 1,180 |
| | | | | | | | |
| Energy Segment | | | | | | | |
| Order backlog | 2 years | 3,298 | (3,298 ) | - | 3,460 | (3,028 ) | 432 |
| Tradename - Orbital | 10 years | 1,773 | (488 ) | 1,285 | 1,861 | (326 ) | 1,535 |
| Customer list - Orbital | 10 years | 6,895 | (1,896 ) | 4,999 | 7,235 | (1,266 ) | 5,969 |
| Technology rights | 20 years** | 370 | (90 ) | 280 | 388 | (56 ) | 332 |
| Technology-Based Asset - Know How | 12 years | 2,793 | (640 ) | 2,153 | 2,931 | (428 ) | 2,503 |
| Technology-Based Asset - Software | 10 years | 605 | (166 ) | 439 | 635 | (111 ) | 524 |
| Computer software | 3 to 5 years | 2 | (1 ) | 1 | - | - | - |
| Other intangible assets | *** | 11 | (1 ) | 10 | - | - | - |
| Total Energy Segment | | 15,747 | (6,580 ) | 9,167 | 16,510 | (5,215 ) | 11,295 |
| | | | | | | | |
| Other segment | | | | | | | |
| Other intangible assets | *** | 20 | (18 ) | 2 | 20 | (12 ) | 8 |
| | | | | | | | |
| Indefinite-lived intangible assets | | | | | | | |
| Power and Electro-Mechanical Segment | | | | | | | |
| Trade mark and tradename - CUI | | 4,893 | - | 4,893 | 4,893 | - | 4,893 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Customer list - CUI | 1,857 | - | 1,857 | 1,857 | - | 1,857 |
| Patents pending - Technology | 552 | - | 552 | 552 | - | 552 |
| | 7,302 | - | 7,302 | 7,302 | - | 7,302 |
| Total Identifiable other intangible assets | $ 27,745 | $ (8,999 ) | $ 18,746 | $ 26,772 | $ (6,987 ) | $ 19,785 |

* All intangibles are reviewed annually for impairment, or sooner if circumstances change.

** Technology rights are amortized over a 20-year life or the term of the rights agreement.

*** Other intangible assets are amortized over an appropriate useful life, as determined by management in relation to the other intangible asset characteristics.

Management reviews the goodwill and other intangible assets for impairment when facts or circumstances suggest. As of December 31, 2015, management has evaluated the finite-lived and indefinite-lived goodwill and other intangible assets and believes no additional impairment exists.

Amortization expense from continuing operations for the years ended December 31, 2015, 2014 and 2013 amounted to $2.4 million, $3.7 million, and $2.7 million, respectively.

The following table reflects the carrying amount of goodwill as of December 31, 2015, and 2014, and the 2015 activity (in thousands):

| | Power and Electro - Mechanical | Gas | Other | Total |
|---|---|---|---|---|
| Balance, December 31, 2014 | $ 13,021 | $8,866 | $ - | $21,887 |
| CUI - Canada, Inc. acquisition | 64 | - | - | 64 |
| Currency translation adjustments | (8 ) | (416 ) | - | (424 ) |
| Balance, December 31, 2015 | $ 13,077 | $8,450 | $ - | $21,527 |

*Order backlog*

As of December 31, 2015, $3.3 million of costs related to Orbital order backlog have been capitalized. Amortization expense of order backlog during 2015 was $0.4 million compared to $1.8 million and $1.3 million in 2014 and 2013, respectively. This asset was acquired with the acquisition Orbital in 2013. The order backlog was fully amortized in 2015.

*Trademarks and trade name*

As of December 31, 2015, $4.9 million of costs related to the CUI tradename (considered indefinite lived and not amortized), $1.1 million of costs related to the V-Infinity brand, $1.8 million related to Orbital trademarks and trade names, $0.1 million related to CUI Canada trademark and tradename and $27 thousand related to the AMP Group's Trademark and tradename have been capitalized. Amortization expense of trademarks and trade names during 2015 was approximately $0.4 million compared to $0.4 million and $0.4 million, in 2014 and 2013, respectively. The estimated annual amortization expense related to trademarks and trade names as of December 31, 2015 is expected to be $0.4 million in 2016, $0.3 million in 2017, $0.2 million in 2018, $0.2 million in 2019 $0.2 million in 2020 and $0.4 million thereafter.

*Customer lists*

As of December 31, 2015, $6.9 million of costs related to the Orbital customer lists, $0.3 million related to CUI Canada customer lists and $1.9 million related to the CUI customer lists have been capitalized. The CUI customer list is considered to have an indefinite life. Amortization expense of customer lists during 2015, 2014, and 2013 was approximately $0.7 million, $0.8 million, and $0.5 million, respectively. The estimated annual amortization of the amortizable customer lists as of December 31, 2015 is expected to be $0.7 million in 2016, $0.7 million in 2017, $0.7 million in 2018, $0.7 million in 2019 $0.7 million in 2020 and $1.6 million thereafter.

*Technology rights*

As of December 31, 2015, $1.6 million of costs related to technology rights have been capitalized including $1.0 million related to our CUI Canada acquisition in March 2015. The CUI Canada Technology rights are amortized over a 7-year life. The rest of the technology rights are amortized over a 20-year life. Amortization expense of technology rights during 2015 was approximately $0.2 million compared to $68 thousand in 2014 and $44 thousand in 2013. The estimated annual amortization expense related to existing technology rights as of December 31, 2015 is expected to be $0.2 million in 2016, $0.2 million in 2017, $0.2 million in 2018, $0.2 million in 2019 $0.2 million in 2020 and $0.3 million thereafter.

*Technology-based assets*

As of December 31, 2015, $2.8 million of technology-based assets – ‘‘know how’’ have been capitalized. Also at December 31, 2015, $0.6 million of technology-based assets - software have been capitalized. Amortization expense of technology-based assets during 2015, 2014 and 2013 was approximately $0.3 million, $0.3 million and $0.2 million, respectively. These assets were acquired in 2013 with the acquisition of Orbital. The estimated annual amortization expense related to existing technology-based assets as of December 31, 2015 is expected to be $0.3 million in 2016, $0.3 million in 2017, $0.3 million in 2018, $0.3 million in 2019 $0.3 million in 2020 and $1.1 million thereafter.

*Debt offering costs*

During the year ended December 31, 2013, the amortization expense related to debt offering costs was $43 thousand. There was no amortization expense of debt offering costs in 2015 or 2014 as the debt offering costs were fully amortized in 2013.

*Computer software*

As of December 31, 2015, $1.0 million of computer software costs have been capitalized. Amortization expense of computer software during 2015, 2014 and 2013 was approximately $69 thousand, $52 thousand and $55 thousand, respectively. The estimated annual amortization expense related to current computer software as of December 31, 2015 is expected to be $96 thousand in 2016, $59 thousand in 2017, $23 thousand in 2018, $13 thousand in 2019, and $2 thousand in 2020.

*Product Certifications*

As of December 31, 2015, $0.8 million of product certifications have been capitalized. Amortization expense of product certifications during 2015, 2014 and 2013 was approximately $0.2 million, 0.2 million and 0.1 million, respectively. The estimated annual amortization expense related to product certifications as of December 31, 2015 is expected to be $0.2 million in 2016, $0.1 million in 2017, and $0.1 million in 2018.

*Other intangible assets*

As of December 31, 2015, $0.7 million of other intangible assets have been capitalized. These assets are amortizing over various estimated useful lives based on their individual characteristics. Of the balance at December 31, 2015, $0.6 million relates to AMT patent pending technology that is considered indefinite lived and not amortized. During 2015, 2014 and 2013, the amortization expense related to other intangible assets was approximately $22 thousand, $25 thousand, and $25 thousand, respectively. The estimated annual amortization expense related to existing other intangible assets as of December 31, 2015 is expected to be $23 thousand in 2016, $9 thousand in 2017, $4 thousand in 2018, $3 thousand in 2019 $2 thousand in 2020 and $less than a thousand thereafter.

## 7. CAPITAL LEASES

The following is an analysis of the leased property under capital leases by major classes as of December 31, 2015 and 2014 (in thousands):

| | Asset Balances at December 31, | |
|---|---|---|
| | 2015 | 2014 |
| Classes of Property | | |
| Motor vehicles | $118 | $173 |
| Equipment | 21 | 22 |
| Less: Accumulated depreciation | (71 ) | (76 ) |
| | $68 | $119 |

88

The following summarizes the current and long-term portion of capital leases at December 31, 2015 and 2014 (in thousands):

| | Balances at December 31, | |
|---|---|---|
| | 2015 | 2014 |
| Current leases payable | $41 | $33 |
| Long-term leases payable | 29 | 74 |
| | $70 | $107 |

| | |
|---|---|
| 2016 | $44 |
| 2017 | 31 |
| 2018 | - |
| 2019 | - |
| 2020 | - |
| Thereafter | - |
| Total minimum lease payments | 75 |
| Amount representing interest | 5 |
| Present value of minimum lease payments with average interest rate of 7.44% | 70 |
| Current portion of capital lease obligation | 41 |
| Capital lease obligation, less current portion | $29 |

## 8. INSTRUMENTS AND RISK MANAGEMENT

The Company has limited involvement with derivative instruments and does not trade them. The Company does use derivatives to manage certain interest rate and foreign currency exchange rate exposures.

At December 31, 2015 and 2014, the Company had no derivative instruments designated as effective hedges.

From time to time, to minimize risk associated with foreign currency exposures on receivables for sales denominated in foreign currencies, the Company enters into various foreign currency forward exchange contracts, which are intended to minimize the currency exchange rate exposure from expected future cash flows. The forward currency contracts have maturity dates of up to one year at the date of inception. At December 31, 2015 and 2014, no foreign currency forward exchange contracts were outstanding.

The Company also entered into an interest rate swap, which has a maturity date of ten years from the date of inception.

In conjunction with the mortgage note payable for the purchase of the headquarters facility completed in 2013, the Company entered into a Swap Transaction Confirmation agreement effective October 1, 2013 incorporating the terms and definitions of the International Swaps and Derivatives Association, Inc. (ISDA) that effectively fixes our effective annual interest rate at 6.27%.

The impact of these instruments on the statement of operations in 2015, 2014 and 2013 is summarized below:

| (in thousands) | Location of Gain (loss) Recognized in Income | Amount of Gain (loss) Recognized in Income | | |
|---|---|---|---|---|
| | | 2015 | 2014 | 2013 |
| Foreign currency forward exchange contracts: | Other income (expense) | $ - | $ - | $ 2 |
| Interest rate swap: | Other income (expense) | $ 20 | $ (172 ) | $ (428 ) |

## 9. NOTES PAYABLE

Notes payable is summarized as follows at December 31, 2015 and 2014 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| (a) Mortgage note payable | $3,524 | $3,604 |
| (b) Acquisition Note Payable - related party | 5,304 | 5,304 |
| Ending Balance | $8,828 | $8,908 |

(a) On October 1, 2013, the funding of the purchase of the Company's Tualatin, Oregon corporate offices from Barakel, LLC was completed. The purchase price for this asset was $5.1 million. The purchase was funded, in part, by a promissory note payable to Wells Fargo Bank in the amount of $3.7 million plus interest at the rate of 2% above LIBOR, payable over ten years with a balloon payment due at maturity. It was secured by a deed of trust on the purchased property, which was executed by CUI Properties, LLC and guaranteed by CUI Global, Inc. During 2015, the Company made principal payments of approximately $81 thousand against the mortgage promissory note payable. At December 31, 2015, the balance owed on the mortgage promissory note payable was $3.5 million of which $85 thousand and $3.4 million were in current and long-term liabilities, respectively. At December 31, 2014, the balance owed on the mortgage promissory note payable was $3.6 million of which $81 thousand and $3.5 million were in current and long-term liabilities, respectively.

(b) The note payable to International Electronic Devices, Inc. (formerly CUI, Inc.) is associated with the acquisition of CUI, Inc. The promissory note is due May 15, 2020 and includes a 5% interest rate per annum, with interest payable monthly and the principal due as a balloon payment at maturity. The note contains a contingent conversion feature, such that in the event of default on the note the holder of the note can, at the holder's option, convert the note principal into common stock at $0.001 per share. As of December 31, 2015, the Company is in compliance with all terms of this promissory note and the conversion feature is not effective.

The following table details the maturity of the notes payable and mortgage note payable for CUI Global, Inc. as of December 31, 2015:

| Notes Payable Maturities | |
|---|---|
| 2016 | $85 |
| 2017 | 89 |
| 2018 | 94 |
| 2019 | 99 |
| 2020 | 5,407 |
| Thereafter | 3,054 |
| Total | $8,828 |

**10. WORKING CAPITAL LINE OF CREDIT**

On September 27, 2013, the Company's wholly owned subsidiary, CUI, Inc., closed on a two year revolving Line of Credit (LOC) with Wells Fargo Bank with the following terms:

(in thousands)

| Credit Limit | 12/31/2015 balance | Expiration Date | Interest rate |
|---|---|---|---|
| $4,000 | $- | October 1, 2016 | Fixed rate at 1.75% above the LIBOR in effect on the first day of the applicable fixed-rate term, or Variable rate at 1.75% above the the daily one-month LIBOR rate |

On October 1, 2014, the Company extended the term of the LOC to October 1, 2016.

At December 31, 2015, the LOC is secured by the following collateral via a security agreement on CUI, Inc. (in thousands)

| | |
|---|---|
| CUI Inc. General intangibles, net | $9,489 |
| CUI Inc. Accounts receivable, net | 7,798 |
| CUI Inc. Inventory, net | 6,388 |
| CUI Inc. Equipment, net | 930 |

CUI Global, Inc., the parent company is a payment guarantor of the LOC. Other terms included in this revolving line of credit for CUI Inc. limit capital expenditures by CUI Inc. to $1.2 million in any fiscal year.

At December 31, 2015 and 2014, respectively, the balance outstanding on the line of credit was $0. As of the date of this filing, the Company is compliant with all covenants on the line of credit with Wells Fargo Capital Finance.

## 11. COMMITMENTS AND CONTINGENCIES

Legal Matters

The Company may be involved in certain legal actions arising from the ordinary course of business. While it is not feasible to predict or determine the outcome of these matters, we do not anticipate that any of these matters, or these matters in the aggregate, will have a material adverse effect on the financial position or results of operations.

Commissions, Royalty and License Fee Agreements

The Company has minimum commitments under certain royalty agreements. Royalty and license fees are paid in accordance with their related agreements, either on a monthly or quarterly basis. As of December 31, 2015, $26 thousand was accrued for royalty and license fees payable, and is reported as a current liability in accrued expenses.

External Sales Representative Commissions

Commissions to external sales representatives are paid in accordance with their related agreements, either on a monthly or annual basis. As of December 31, 2015, $0.1 million was accrued for commissions to external sales representatives, and is reported as a current liability in accrued expenses.

Employment Agreements

As of the year ended December 31, 2015, the following employment agreements were in place:

*William J. Clough, President/Chief Executive Officer and General Counsel of CUI Global, Inc., Chief Executive Officer of CUI, Inc. and Chief Executive Officer of Orbital Gas Systems, Ltd.*

Mr. Clough is employed under a multi-year employment contract with the Company, which was recently extended to run to and through December 31, 2018. Said contract provides, in relevant part, for an initial annual salary of $460 thousand, which became effective July 1, 2013 and includes bonus provisions for each calendar year up to 125% of base salary to be based on performance objectives, goals and milestones for each calendar year including revenue performance and entitles Mr. Clough to a two-year severance package and an annual 4% cost of living adjustment (2015 salary of $498 thousand). Bonuses are approved quarterly based on various performance-related factors and an evaluation of current performance and includes a discretionary bonus of up to twenty-five percent of salary based upon the reasonable judgment of the compensation committee. Employee has the ability to earn a larger bonus based on the performance criteria set forth and the reasonable judgment and discretion of the compensation committee. All such bonus payments shall be paid to Mr. Clough in equal monthly installments following the period in which the bonus is earned and shall be paid on the 15th day of each month. During 2013, in accordance with the bonus provisions of his employment contract, Mr. Clough received 33,350 shares of common stock with a fair value of $160,080. At December 31, 2015 and 2014, there was an accrual of $4 thousand and $14 thousand, respectively, for compensation owed to Mr. Clough. Effective June 24, 2013, Mr. Clough received a bonus option to purchase 200,000 common shares within ten years from date of issuance, at a price of $6.25 per share that vests one third each year over three years.

*Daniel N. Ford, Chief Financial Officer of CUI Global Inc. and Subsidiaries*

Mr. Ford is employed under a three-year employment contract with the Company, which was extended to December 31, 2017 and provides, in relevant part, for an initial annual salary of $250 thousand effective July 1, 2013 (2015 salary of $270 thousand), an annual 4% cost of living adjustment, an eighteen month severance package and bonus provisions up to 125% of base salary to be based on performance objectives, goals and milestones for each calendar year including revenue performance. The bonus includes a discretionary bonus of up to twenty-five percent of salary based upon the reasonable judgment of the compensation committee. Employee has the ability to earn a larger bonus based on the performance criteria set forth and the reasonable judgment and discretion of the compensation committee. Previous to July 1, 2013, Mr. Ford’s employment contract provided, in relevant part, for an annual salary of $195 thousand and bonus provisions for each calendar year, in which the CUI Global year-end Statement of Operations shows a Net Profit and the Gross Revenue equal to or that exceeds fifteen percent (15%), but less than thirty percent (30%), of the immediate preceding calendar year, he shall be entitled to receive a cash bonus in an amount equal to fifty percent (50%) of his prior-year base salary in addition to any other compensation to which he may be entitled; provided, however, that he shall be entitled to the bonus only if he has been employed by the Company during that entire calendar year. In substitution of the bonus percentages described above, he shall be entitled to receive, in any year in which annual Gross Revenue exceeds by 30% of the prior-calendar-year gross revenue, a sum equal to 100% of his prior-year base salary. Bonuses are approved quarterly based on the above factors and an evaluation of current performance. All such bonus payments shall be paid to Mr. Ford in equal monthly installments following the period in which the bonus is earned and shall be paid on the 15th day of each month. At December 31, 2015 and 2014 there was an accrual of $18 thousand and $10 thousand, respectively, for compensation owed to Mr. Ford. Effective June 24, 2013, Mr. Ford received a bonus option to purchase 100,000 common shares within ten years from date of issuance, at a price of $6.25 per share that vests one third each year over three years.

*Matthew M. McKenzie, President of CUI, Inc. and Chief Operating Officer and Corporate Secretary of CUI Global, Inc.*

Mr. McKenzie is employed under a three-year employment contract with the Company, which was extended to December 31, 2017 and provides, in relevant part, for an initial annual salary of $250 thousand effective July 1, 2013, an annual 4% cost of living adjustment (2015 salary of $270 thousand), an eighteen month severance package and bonus provisions up to 125% of base salary to be based on performance objectives, goals, and milestones for each calendar year, including revenue performance in the power and electromechanical segment. The bonus includes a discretionary bonus of up to twenty-five percent of salary based upon the reasonable judgment of the compensation committee. Employee has the ability to earn a larger bonus based on the performance criteria set forth and the reasonable judgment and discretion of the compensation committee. Bonuses are approved quarterly based on the above factors and an evaluation of current performance. Previous to July 1, 2013, Mr. McKenzie’s employment contract provided, in relevant part, for an annual salary of $205 thousand and bonus provisions for each calendar year in which the CUI Global year-end Statement of Operations shows a Net Profit and the Gross Revenue equal to or that exceeds fifteen percent (15%), but less than thirty percent (30%), of the immediate preceding calendar year, he shall be entitled to receive a cash bonus in an amount equal to fifty percent (50%) of his prior year base salary in addition to any other compensation to which he may be entitled; provided, however, that he shall be entitled to the bonus only if he has been employed by the Company during that entire calendar year. In substitution of the bonus percentages described above, he shall be entitled to receive, in any year in which annual Gross Revenue exceeds by 30% of the prior-calendar-year gross revenue, a sum equal to 100% of his prior-year base salary. Bonuses are approved quarterly based on the above factors and an evaluation of current performance. All such bonus payments shall be paid to Mr. McKenzie in equal monthly installments following the period in which the bonus is earned and shall be paid on the 15th day of each month. At December 31, 2015 and 2014 there was an accrual of $23 thousand and $19 thousand, respectively, for compensation owed to Mr. McKenzie. Effective June 24, 2013, Mr. McKenzie received a bonus option to purchase 50,000 common shares within ten years from date of issuance, at a price of $6.25 per share that vests one third each year over three years.

Leases

As an integrated part of the Orbital acquisition, CUI Global, Inc. acquired operating leases of Orbital facilities for office and manufacturing space requirements. During the year ended December 31, 2015, the monthly base rent of these leases was approximately $33 thousand.

In January 2015, the Company rented office and warehouse space in Houston, TX. During the year ended December 31, 2015, the monthly rent of this lease was approximately $7 thousand.

In March 2015, as part of the Tectrol acquisition, the Company leased the Toronto facility. During the year ended December 31, 2015, the monthly rent of this lease was approximately $34 thousand dollars per month.

Additionally, CUI Japan leases office space. During the year ended December 31, 2015, the monthly base rent of this lease was approximately $3 thousand.

Rental expense was $0.8 million, $0.2 million, and $0.5 million in 2015, 2014 and 2013, respectively, and is included in selling, general and administrative on the statement of operations.

Operating Leases

Future minimum leases (in thousands)

| | |
|---|---|
| 2016 | $565 |
| 2017 | 491 |
| 2018 | 335 |
| 2019 | 300 |
| 2020 | 56 |
| Thereafter | - |
| Total | $1,747 |

**12. STOCKHOLDERS' EQUITY**

Common Stock Dividend Restrictions

As of December 31, 2015, there are no restrictions on common stock dividends. Also, at December 31, 2015 and 2014, retained earnings were not restricted upon involuntary liquidation.

Common Stock Issuances (dollars in thousands)

| Date of issuance | Type of issuance | Expense/ Prepaid/ Cash | Stock issuance recipient | Reason for issuance | Total no. of shares | Grant date fair value recorded at issuance | |
|---|---|---|---|---|---|---|---|
| January 2015 | Vested restricted common stock | Expensed | Two board members | Director compensation | 5,000 | $ 36 | |
| January 2015 | Vested restricted common stock | Expensed | New Director of Sales and Marketing - Orbital Gas Systems, North America | Sign-on bonus | 17,655 | 125 | |
| March 2015 | Vested restricted common stock | $31 thousand included in Prepaid expense and $32 thousand expensed | Consultant | Compensation for strategic investor marketing services | 10,000 | 63 | |
| April 2015 | Common stock | Expensed | Former employee | Cashless stock option exercise | 108 | - | (1) |
| May 2015 | Vested restricted common stock | Expensed | Employee | Approved bonus | 1,391 | 7 | |
| June 2015 | Vested restricted common stock | Expensed | Employee | Approved bonus | 9,560 | 50 | |
| June 2015 | Vested restricted common stock | Expensed | Director | Director compensation | 1,753 | 10 | |
| July 2015 | Vested restricted common | Expensed | Employee | Bonus compensation | 3,453 | 15 | |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | stock | | | | | | | | |
| July 2015 | Common stock | Expensed | Related party, James McKenzie | Pursuant to royalty agreement | 3,670 | | 20 | | |
| July 2015 | Common stock | Expensed | Related party, IED, Inc. | Pursuant to royalty agreement | 400 | | 2 | | |
| August 2015 | Common stock | Expensed | Employee | Cashless Stock option exercise | 14 | | - | | (1) |
| August 2015 | Vested restricted common stock | Expensed | Director | Director compensation | 4,497 | | 25 | | |
| November 2015 | Vested restricted common stock | Expensed | Director | Director compensation | 978 | | 6 | | |
| Total 2015 issuances | | | | | 58,479 | | $ 359 | | (2) |
| January, February, March, April and November 2014 | Common stock | Expensed | Three employees, one officer and one former director | Cashless option exercises | 31,850 | | - | | (1) |
| February, March, August and December 2014 | Common stock | Expensed | Four consultants including former board member | Consideration for services | 131,365 | (3) | 932 | | |
| March and December 2014 | Common stock | Expensed | Related party, James McKenzie | Pursuant to royalty agreement | 4,555 | | 31 | | |
| June 2014 | Common stock | Expensed | Related party, Director at Orbital | Bonus | 5,624 | | 50 | | |
| August 2014 | Common stock | Expensed | 3 Directors | Director compensation | 6,435 | | 48 | | |
| December 2014 | Common stock | Expensed | Director | Director compensation | 1,248 | | 10 | | |
| Total 2014 issuances | | | | | 181,077 | | $ 1,071 | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| April 2013 | Common stock | Cash | Underwriters | S-1 Issuance of stock | 9,660,000 (4) | 45,135 (5) |
| June 2013 | Common stock | Expensed | 22 employees | Bonus | 16,305 | 91 |
| June 2013 | Common stock | Expensed | Related party, James McKenzie | Pursuant to royalty agreement | 4,578 | 25 |
| December 2013 | Common stock | Expensed | Consultant | Consideration for services | 2,500 | 16 |
| Total 2013 issuances | | | | | 9,683,383 | $ 45,267 |

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(1) The Company received $0 for the issuance in the cashless option exercise

(2) There was $404 thousand of stock-based expense related to employee stock-based bonuses and vested restricted stock units held by a Director that were earned in 2015 but not issued until the first quarter of 2016.

(3) The second phase of this consulting agreement could result in up to an additional 150,000 shares of common stock being granted subject to sales related performance criteria being achieved. At December 31, 2015, those criteria have not been achieved and no shares have been granted for the second phase of the agreement.

(4) Included 1,260,000 over-allotment shares.

(5) Gross value was $48.3 million. Amount shown is net of $3.2 million of transaction costs and commissions.

Employee Stock Options and Warrants

All options and warrants issued are presented at post reverse quantities.

On May 16, 2008 the Company's board of directors adopted the Waytronx, Inc. 2008 Equity Incentive Plan (the ''Equity Incentive Plan'') and authorized 1,500,000 shares of Common Stock to fund the Plan. At the 2008 Annual Meeting of Shareholders held on September 15, 2008, the Equity Incentive Plan was approved by the Company shareholders. At the 2009 Annual Meeting of Shareholders held on September 29, 2009, the shareholders approved an amendment to the 2008 Equity Incentive Plan to increase the number of common shares issuable under the plan from 1,500,000 to 3,000,000. All of these shares have been registered under Form S-8.

The 2008 Equity Incentive Plan is intended to: (a) provide incentive to employees of the Company and its affiliates to stimulate their efforts toward the continued success of the Company and to operate and manage the business in a manner that will provide for the long-term growth and profitability of the Company; (b) encourage stock ownership by employees, directors and independent contractors by providing them with a means to acquire a proprietary interest in the Company by acquiring shares of Stock or to receive compensation, which is based upon appreciation in the value of Stock; and (c) provide a means of obtaining and rewarding employees, directors, independent contractors and advisors.

The 2008 Equity Incentive Plan provide for the issuance of incentive stock options (ISOs) and Non Statutory Options (NSOs) to employees, directors and independent contractors of the Company. The Board shall determine the exercise price per share in the case of an ISO at the time an option is granted and such price shall be not less than the fair market value or 110% of fair market value in the case of a ten percent or greater stockholder. In the case of an NSO, the exercise price shall not be less than the fair market value of one share of stock on the date the option is granted. Unless otherwise determined by the Board, ISOs and NSOs granted under the both plans have a maximum duration of ten years.

On January 5, 2009 the Company board of directors received and approved a written report and recommendations of the Compensation Committee, which included a detailed executive equity compensation report and market analysis and the recommendations of Compensia, Inc., a management consulting firm that provides executive compensation advisory services to compensation committees and senior management of knowledge-based companies. The Compensation Committee used the report and analysis as a basis for its formal written recommendation to the board. Pursuant to a January 8, 2009 board resolution the 2009 Equity Incentive Plan (Executive), a Non-Qualified Stock Option Plan, was created and funded with 4,200,000 shares of $0.001 par value common stock. The Compensation Committee was appointed as the Plan Administrator to manage the plan. On October 11, 2010, CUI Global authorized an additional 3,060,382 options under the 2009 Equity Incentive Plan (Executive). On September 21, 2012, CUI Global authorized an additional 330,000 options under the 2009 Equity Incentive Plan (Executive).

The 2009 Equity Incentive Plan (Executive) provides for the issuance of Incentive Non Statutory Options to attract, retain and motivate executive and management employees and directors and to encourage these individuals to acquire an equity interest in the Company, to make monetary payments to certain management employees and directors based upon the value of the Company's stock and to provide these individuals with an incentive to maximize the success of the Company and further the interest of the shareholders. The Administrator of the plan is authorized to determine the exercise price per share at the time the option is granted, but the exercise price shall not be less than the fair market value on the date the option is granted. Stock options granted under the 2009 Plan have a maximum duration of ten years.

At December 31, 2015, there are 1,324,501 shares of common stock available under the 2008 Equity Incentive Stock Plan and 201,361 available under the 2009 Equity Incentive Plan (Executive).

During the years ended 2015, 2014 and 2013, the Company recorded expense for services and compensation in the amount of $0.5 million, $0.7 million, and $0.4 million, respectively, for stock options that the requisite service was performed during the year. The compensation expense is recorded over the vesting period based upon fair market value of the options using the Black-Scholes option model in accordance with FASB ASC 718 as discussed in section Employee Stock Options and Warrants.

The remaining total compensation cost related to nonvested option awards not yet recognized as of December 31, 2015 is $0.2 million, which is expected to be recognized over the weighted average remaining vesting period of 0.64 years.

A summary of the options issued to employees and directors as of December 31, 2015, 2014 and 2013 and changes during the year are presented below:

| | 2013 | | | |
|---|---|---|---|---|
| | Number of Warrants and Options | Weighted Average Exercise Price ($) | Weighted Average Remaining Contract Life | Aggregate Interinsic Value ($ '000) |
| Balance at beginning of year | 682,141 | 6.47 | 8.52 Years | 88 |
| Expired | (1,334 ) | 5.70 | | |
| Granted | 350,000 | 6.25 | | |
| Balance at end of year | 1,030,807 | 6.39 | 8.19 Years | 321 |
| Exercisable | 410,593 | 6.80 | 6.84 Years | 162 |

| | 2014 | | | |
|---|---|---|---|---|
| | Number of Warrants and Options | Weighted Average Exercise Price ($) | Weighted Average Remaining Contract Life | Aggregate Interinsic Value ($ '000) |
| Balance at beginning of year | 1,030,807 | 6.39 | 8.19 Years | 321 |
| Exercised | (129,265 ) | 7.35 | | 302 |
| Expired | (1,000 ) | 5.14 | | |
| Granted | 97,890 | 7.11 | | |
| Balance at end of year | 998,432 | 6.34 | 7.58 Years | 1,206 |
| Exercisable | 673,473 | 6.41 | 7.29 Years | 789 |

| | 2015 | | | — | 21 —50 |
|---|---|---|---|---|---|
| Restructuring-related charges | 4 | — | — | — | 4 |
| Total operating expenses | 693 | 13 | 857 | (106 ) | 1,457 |
| Income (loss) from operations | 20 | 35 | 108 | — | 163 |
| Interest expense | (41 ) | — | (20 ) | 18 | (43 ) |
| Other (expense) income, net | 14 | — | (11 ) | (18 ) | (15 ) |
| Income (loss) from continuing operations before income taxes | (7 ) | 35 | 77 | — | 105 |
| Income tax expense (benefit) | — | 20 | 11 | — | 31 |
| Income (loss) from continuing operations before earnings in subsidiaries | (7 ) | 15 | 66 | — | 74 |
| Equity in earnings of consolidated subsidiaries | 83 | 92 | — | (175 ) | — |
| Income (loss) from continuing operations | 76 | 107 | 66 | (175 ) | 74 |
| Income (loss) from discontinued operations, net of tax | — | — | — | — | — |
| Net income (loss) | $76 | $107 | $66 | $(175) | $ 74 |
| Net income (loss) attributable to noncontrolling interests | — | — | (2 ) | — | (2 ) |
| Net income (loss) attributable to NCR | $76 | $107 | $68 | $(175) | $ 76 |
| Total comprehensive income (loss) | 58 | 66 | 47 | (117 ) | 54 |
| Less comprehensive income (loss) attributable to noncontrolling interests | — | — | (4 ) | — | (4 ) |
| Comprehensive income (loss) attributable to NCR common stockholders | $58 | $66 | $51 | $(117) | $ 58 |

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NCR Corporation
Notes to Condensed Consolidated Financial Statements (Unaudited)—(Continued)

Condensed Consolidating Statements of Operations and Comprehensive Income (Loss)
For the six months ended June 30, 2017

| (in millions) | Parent Issuer | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Product revenue | $610 | $ 53 | $ 673 | $ (164 ) | $ 1,172 |
| Service revenue | 827 | 14 | 1,058 | — | 1,899 |
| Total revenue | 1,437 | 67 | 1,731 | (164 ) | 3,071 |
| Cost of products | 464 | 22 | 580 | (164 ) | 902 |
| Cost of services | 576 | 5 | 712 | — | 1,293 |
| Selling, general and administrative expenses | 234 | 2 | 220 | — | 456 |
| Research and development expenses | 60 | — | 65 | — | 125 |
| Total operating expenses | 1,334 | 29 | 1,577 | (164 ) | 2,776 |
| Income (loss) from operations | 103 | 38 | 154 | — | 295 |
| Interest expense | (78 ) | — | (35 ) | 33 | (80 ) |
| Other (expense) income, net | 9 | (1 ) | 11 | (33 ) | (14 ) |
| Income (loss) from continuing operations before income taxes | 34 | 37 | 130 | — | 201 |
| Income tax expense (benefit) | 9 | 18 | 20 | — | 47 |
| Income (loss) from continuing operations before earnings in subsidiaries | 25 | 19 | 110 | — | 154 |
| Equity in earnings of consolidated subsidiaries | 129 | 97 | — | (226 ) | — |
| Income (loss) from continuing operations | 154 | 116 | 110 | (226 ) | 154 |
| Income (loss) from discontinued operations, net of tax | 5 | — | — | — | 5 |
| Net income (loss) | $159 | $ 116 | $ 110 | $ (226 ) | $ 159 |
| Net income (loss) attributable to noncontrolling interests | — | — | — | — | — |
| Net income (loss) attributable to NCR | $159 | $ 116 | $ 110 | $ (226 ) | $ 159 |
| Total comprehensive income (loss) | 174 | 141 | 119 | (260 ) | 174 |
| Less comprehensive income (loss) attributable to noncontrolling interests | — | — | — | — | — |
| Comprehensive income (loss) attributable to NCR common stockholders | $174 | $ 141 | $ 119 | $ (260 ) | $ 174 |

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NCR Corporation
Notes to Condensed Consolidated Financial Statements (Unaudited)—(Continued)

Condensed Consolidating Statements of Operations and Comprehensive Income (Loss)
For the six months ended June 30, 2016

| (in millions) | Parent Issuer | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Product revenue | $552 | $ 55 | $ 787 | $ (170) | $ 1,224 |
| Service revenue | 776 | 17 | 1,047 | — | 1,840 |
| Total revenue | 1,328 | 72 | 1,834 | (170) | 3,064 |
| Cost of products | 430 | 16 | 683 | (170) | 959 |
| Cost of services | 570 | 6 | 703 | — | 1,279 |
| Selling, general and administrative expenses | 250 | 2 | 201 | — | 453 |
| Research and development expenses | 57 | — | 46 | — | 103 |
| Restructuring-related charges | 6 | — | — | — | 6 |
| Total operating expenses | 1,313 | 24 | 1,633 | (170) | 2,800 |
| Income (loss) from operations | 15 | 48 | 201 | — | 264 |
| Interest expense | (86) | — | (38) | 35 | (89) |
| Other (expense) income, net | 25 | (5) | (10) | (35) | (25) |
| Income (loss) from continuing operations before income taxes | (46) | 43 | 153 | — | 150 |
| Income tax expense (benefit) | (21) | 25 | 40 | — | 44 |
| Income (loss) from continuing operations before earnings in subsidiaries | (25) | 18 | 113 | — | 106 |
| Equity in earnings of consolidated subsidiaries | 133 | 133 | — | (266) | — |
| Income (loss) from continuing operations | 108 | 151 | 113 | (266) | 106 |
| Income (loss) from discontinued operations, net of tax | — | — | — | — | — |
| Net income (loss) | $108 | $ 151 | $ 113 | $ (266) | $ 106 |
| Net income (loss) attributable to noncontrolling interests | — | — | (2) | — | (2) |
| Net income (loss) attributable to NCR | $108 | $ 151 | $ 115 | $ (266) | $ 108 |
| Total comprehensive income (loss) | 82 | 101 | 75 | (184) | 74 |
| Less comprehensive income (loss) attributable to noncontrolling interests | — | — | (8) | — | (8) |
| Comprehensive income (loss) attributable to NCR common stockholders | $82 | $ 101 | $ 83 | $ (184) | $ 82 |

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NCR Corporation
Notes to Condensed Consolidated Financial Statements (Unaudited)—(Continued)

Condensed Consolidating Balance Sheet
June 30, 2017

| (in millions) | Parent Issuer | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | $18 | $ 10 | $ 349 | $ — | $ 377 |
| Accounts receivable, net | 59 | 19 | 1,243 | — | 1,321 |
| Inventories | 304 | 12 | 512 | — | 828 |
| Due from affiliates | 627 | 1,633 | 497 | (2,757) | — |
| Other current assets | 131 | 40 | 181 | (62) | 290 |
| Total current assets | 1,139 | 1,714 | 2,782 | (2,819) | 2,816 |
| Property, plant and equipment, net | 153 | — | 151 | — | 304 |
| Goodwill | 988 | — | 1,748 | — | 2,736 |
| Intangibles, net | 162 | — | 456 | — | 618 |
| Prepaid pension cost | — | — | 107 | — | 107 |
| Deferred income taxes | 530 | 98 | 85 | (102) | 611 |
| Investments in subsidiaries | 3,440 | 2,844 | — | (6,284) | — |
| Due from affiliates | 1,019 | 1 | 38 | (1,058) | — |
| Other assets | 426 | 57 | 92 | — | 575 |
| Total assets | $7,857 | $ 4,714 | $ 5,459 | $ (10,263) | $ 7,767 |
| | | | | | |
| Liabilities and stockholders' equity | | | | | |
| Current liabilities | | | | | |
| Short-term borrowings | $52 | $ — | $ 215 | $ — | $ 267 |
| Accounts payable | 310 | 2 | 419 | — | 731 |
| Payroll and benefits liabilities | 105 | — | 100 | — | 205 |
| Deferred service revenue and customer deposits | 236 | 4 | 281 | — | 521 |
| Due to affiliates | 1,916 | 140 | 701 | (2,757) | — |
| Other current liabilities | 200 | 3 | 248 | (62) | 389 |
| Total current liabilities | 2,819 | 149 | 1,964 | (2,819) | 2,113 |
| Long-term debt | 3,013 | — | 2 | — | 3,015 |
| Pension and indemnity plan liabilities | 481 | — | 283 | — | 764 |
| Postretirement and postemployment benefits liabilities | 24 | 3 | 100 | — | 127 |
| Income tax accruals | 17 | 2 | 121 | — | 140 |
| Due to affiliates | — | 38 | 1,020 | (1,058) | — |
| Other liabilities | 75 | 5 | 183 | (102) | 161 |
| Total liabilities | 6,429 | 197 | 3,673 | (3,979) | 6,320 |
| Redeemable noncontrolling interest | — | — | 14 | — | 14 |
| Series A convertible preferred stock | 786 | — | — | — | 786 |
| Stockholders' equity | | | | | |
| Total NCR stockholders' equity | 642 | 4,517 | 1,767 | (6,284) | 642 |
| Noncontrolling interests in subsidiaries | — | — | 5 | — | 5 |
| Total stockholders' equity | 642 | 4,517 | 1,772 | (6,284) | 647 |
| Total liabilities and stockholders' equity | $7,857 | $ 4,714 | $ 5,459 | $ (10,263) | $ 7,767 |

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NCR Corporation
Notes to Condensed Consolidated Financial Statements (Unaudited)—(Continued)

Condensed Consolidating Balance Sheet
December 31, 2016

| (in millions) | Parent Issuer | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | $65 | $ 12 | 421 | $ — | $ 498 |
| Accounts receivable, net | 64 | 25 | 1,193 | — | 1,282 |
| Inventories | 272 | 13 | 414 | — | 699 |
| Due from affiliates | 680 | 1,509 | 400 | (2,589) | — |
| Other current assets | 140 | 37 | 162 | (61) | 278 |
| Total current assets | 1,221 | 1,596 | 2,590 | (2,650) | 2,757 |
| Property, plant and equipment, net | 129 | — | 158 | — | 287 |
| Goodwill | 988 | — | 1,739 | — | 2,727 |
| Intangibles, net | 176 | — | 496 | — | 672 |
| Prepaid pension cost | — | — | 94 | — | 94 |
| Deferred income taxes | 499 | 98 | 82 | (104) | 575 |
| Investments in subsidiaries | 3,275 | 2,822 | — | (6,097) | — |
| Due from affiliates | 1,053 | — | 35 | (1,088) | — |
| Other assets | 405 | 56 | 100 | — | 561 |
| Total assets | $7,746 | $ 4,572 | $ 5,294 | $ (9,939) | $ 7,673 |
| Liabilities and stockholders' equity | | | | | |
| Current liabilities | | | | | |
| Short-term borrowings | $46 | $ — | $ 4 | $ — | $ 50 |
| Accounts payable | 310 | 2 | 469 | — | 781 |
| Payroll and benefits liabilities | 129 | — | 105 | — | 234 |
| Deferred service revenue and customer deposits | 193 | 5 | 270 | — | 468 |
| Due to affiliates | 1,736 | 154 | 699 | (2,589) | — |
| Other current liabilities | 224 | 6 | 263 | (61) | 432 |
| Total current liabilities | 2,638 | 167 | 1,810 | (2,650) | 1,965 |
| Long-term debt | 2,998 | — | 3 | — | 3,001 |
| Pension and indemnity plan liabilities | 473 | — | 266 | — | 739 |
| Postretirement and postemployment benefits liabilities | 24 | 3 | 100 | — | 127 |
| Income tax accruals | 17 | 4 | 121 | — | 142 |
| Due to affiliates | — | 35 | 1,053 | (1,088) | — |
| Other liabilities | 54 | 5 | 183 | (104) | 138 |
| Total liabilities | 6,204 | 214 | 3,536 | (3,842) | 6,112 |
| Redeemable noncontrolling interest | — | — | 15 | — | 15 |
| Series A convertible preferred stock | 847 | — | — | — | 847 |
| Stockholders' equity | | | | | |
| Total NCR stockholders' equity | 695 | 4,358 | 1,739 | (6,097) | 695 |
| Noncontrolling interests in subsidiaries | — | — | 4 | — | 4 |
| Total stockholders' equity | 695 | 4,358 | 1,743 | (6,097) | 699 |
| Total liabilities and stockholders' equity | $7,746 | $ 4,572 | $ 5,294 | $ (9,939) | $ 7,673 |

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NCR Corporation
Notes to Condensed Consolidated Financial Statements (Unaudited)—(Continued)

Condensed Consolidating Statement of Cash Flows
For the six months ended June 30, 2017

| (in millions) | Parent Issuer | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Net cash provided by (used in) operating activities | $258 | $ (22) | $ (92) | $ (6) | $ 138 |
| Investing activities | | | | | |
| Expenditures for property, plant and equipment | (25) | — | (18) | — | (43) |
| Additions to capitalized software | (57) | — | (27) | — | (84) |
| Proceeds from (payments of) intercompany notes | 133 | 20 | — | (153) | — |
| Investments in equity affiliates | (2) | — | — | 2 | — |
| Other investing activities, net | (1) | — | 1 | — | — |
| Net cash provided by (used in) investing activities | 48 | 20 | (44) | (151) | (127) |
| Financing activities | | | | | |
| Short term borrowings, net | 2 | — | 11 | — | 13 |
| Payments on term credit facilities | (23) | — | (2) | — | (25) |
| Payments on revolving credit facilities | (575) | — | (40) | — | (615) |
| Borrowings on revolving credit facilities | 615 | — | 240 | — | 855 |
| Repurchase of Company common stock | (350) | — | — | — | (350) |
| Proceeds from employee stock plans | 8 | — | — | — | 8 |
| Other financing activities | (1) | — | — | — | (1) |
| Equity contribution | — | — | 2 | (2) | — |
| Dividend distribution to consolidated subsidiaries | — | — | (6) | 6 | — |
| Borrowings (repayments) of intercompany notes | — | — | (153) | 153 | — |
| Tax withholding payments on behalf of employees | (24) | — | — | — | (24) |
| Net cash provided by (used in) financing activities | (348) | — | 52 | 157 | (139) |
| Cash flows from discontinued operations | | | | | |
| Net cash used in operating activities | (5) | — | — | — | (5) |
| Effect of exchange rate changes on cash and cash equivalents | — | — | 12 | — | 12 |
| Increase (decrease) in cash and cash equivalents | (47) | (2) | (72) | — | (121) |
| Cash and cash equivalents at beginning of period | 65 | 12 | 421 | — | 498 |
| Cash and cash equivalents at end of period | $18 | $ 10 | $ 349 | $ — | $ 377 |

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NCR Corporation
Notes to Condensed Consolidated Financial Statements (Unaudited)—(Continued)

Condensed Consolidating Statement of Cash Flows
For the six months ended June 30, 2016

| (in millions) | Parent Issuer | Guarantor Subsidiary | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Net cash provided by (used in) operating activities | $206 | $ (74) | $ 14 | $ (2) | $ 144 |
| Investing activities | | | | | |
| Expenditures for property, plant and equipment | (9) | — | (15) | — | (24) |
| Additions to capitalized software | (45) | — | (29) | — | (74) |
| Proceeds from (payments of) intercompany notes | 123 | 78 | — | (201) | — |
| Investments in equity affiliates | (9) | — | — | 9 | — |
| Proceeds from divestiture | 22 | — | 25 | — | 47 |
| Other investing activities, net | (8) | — | — | — | (8) |
| Net cash provided by (used in) investing activities | 74 | 78 | (19) | (192) | (59) |
| Financing activities | | | | | |
| Short term borrowings, net | (4) | — | 5 | — | 1 |
| Payments on term credit facilities | (67) | — | (6) | — | (73) |
| Payments on revolving credit facilities | (351) | — | (80) | — | (431) |
| Borrowings on revolving credit facilities | 426 | — | 280 | — | 706 |
| Repurchase of Company common stock | (250) | — | — | — | (250) |
| Debt issuance costs | (8) | — | — | — | (8) |
| Proceeds from employee stock plans | 6 | — | — | — | 6 |
| Equity contribution | — | — | 9 | (9) | — |
| Dividend distribution to consolidated subsidiaries | — | — | (2) | 2 | — |
| Borrowings (repayments) of intercompany notes | — | — | (201) | 201 | — |
| Tax withholding payments on behalf of employees | (7) | — | — | — | (7) |
| Net cash provided by (used in) financing activities | (255) | — | 5 | 194 | (56) |
| Cash flows from discontinued operations | | | | | |
| Net cash used in operating activities | (20) | — | — | — | (20) |
| Effect of exchange rate changes on cash and cash equivalents | — | (2) | (3) | — | (5) |
| Increase (decrease) in cash and cash equivalents | 5 | 2 | (3) | — | 4 |
| Cash and cash equivalents at beginning of period | 15 | 20 | 293 | — | 328 |
| Cash and cash equivalents at end of period | $20 | $ 22 | $ 290 | $ — | $ 332 |

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## Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (MD&A)

Overview

The following were the significant events for the second quarter of 2017, each of which is discussed more fully in later sections of this MD&A:

- Revenue decreased approximately 2% from the prior year period, and increased 3% excluding unfavorable foreign currency impacts and adjusting for the divestiture of our Interactive Printer Solutions (IPS) business;
- Software revenue increased 3% from the prior year period, driven by cloud growth of 9%; and
- Gross margin rate expanded 160 basis points to 29.1% as a result of strength in our Services and Hardware segments.

Our long-term strategy is built on being a global technology solutions company that uses software and value-added endpoints, coupled with higher-margin services and a focus on cloud and mobile, to help our customers deliver on the promise of an omni-channel experience.

To deliver on our strategy in 2017, we are focused on sales enablement, services transformation, evolving our software business model, investing in innovation and cultivating our culture and team.

- Sales Enablement - Providing our sales force with the training, tools and processes necessary for consultative selling, supported by a strong solutions management function that innovates the way in which we go to market, and expanding our organization of channel partners.

- Services Transformation - Driving improved services performance by focusing on a higher mix of managed services, improving our productivity and efficiency, expanding our remote diagnostics and repair capabilities and creating greater discipline in our product lifecycle management.

- Evolving our Business Model - Continuing the shift in our business model to provide innovative end-to-end software platform solutions for our customers, with best in class software support while keeping an efficient cost structure to create competitive advantage.

- Investing in Innovation - Optimizing our operating model and prioritizing investments in areas with the greatest potential for profitable growth, such as cloud solutions and professional, managed and other services.

- Cultivating our Culture and Team - Organizing and recruiting with an eye toward the future, and investing in, training and developing our employees to accelerate the delivery of our innovative solutions and to focus on the needs of our customers and changes in consumer behavior.

We plan, in advancing our strategy, to continue to manage our costs effectively, to selectively pursue strategic acquisitions that promote growth and improve gross margin, and to selectively penetrate market adjacencies in single and emerging growth industry segments.

Potentially significant risks to the execution of our initiatives include the strength of demand for automated teller machines and other financial services hardware; domestic and global economic and credit conditions including, in particular, uncertainty in the "BRIC" economies and economic sanctions against Russia, the determination by Britain to exit the European Union, the potential for changes to global or regional trade agreements or the imposition of protectionist trade policies, and the imposition of import or export tariffs or border adjustments; strengthening of the U.S. Dollar resulting in unfavorable foreign currency impacts; collectability difficulties in subcontracting relationships in Middle East and Africa; the possibility of disruptions in or problems with our data center hosting facilities; cybersecurity risks and compliance with data privacy and protection requirements; competition that can drive further price erosion and the potential loss of market share; difficulties associated with the introduction of products in new markets; market adoption of our products by customers; and management and servicing of our existing indebtedness.

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Results from Operations

Three and Six months Ended June 30, 2017 Compared to Three and Six months Ended June 30, 2016

The following table shows our results for the three and six months ended June 30:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| In millions | 2017 | 2016 | 2017 | 2016 |
| Revenue | $1,593 | $1,620 | $3,071 | $3,064 |
| Gross margin | $463 | $446 | $876 | $826 |
| Gross margin as a percentage of revenue | 29.1 % | 27.5 % | 28.5 % | 27.0 % |
| Operating expenses | | | | |
| Selling, general and administrative expenses | $227 | $229 | $456 | $453 |
| Research and development expenses | 58 | 50 | 125 | 103 |
| Restructuring-related charges | — | 4 | — | 6 |
| Income from operations | $178 | $163 | $295 | $264 |

The following table shows our revenue by geographic theater for the three months ended June 30:

| In millions | 2017 | % of Total | 2016 | % of Total | % Increase (Decrease) | % Increase (Decrease) Adjusted Constant Currency (1) |
|---|---|---|---|---|---|---|
| Americas | $915 | 57% | $919 | 57% | —% | 3% |
| Europe, Middle East Africa (EMEA) | 454 | 29% | 477 | 29% | (5)% | 2% |
| Asia Pacific (APJ) | 224 | 14% | 224 | 14% | —% | 3% |
| Consolidated revenue | $1,593 | 100% | $1,620 | 100% | (2)% | 3% |

The following table shows our revenue by geographic theater for the six months ended June 30:

| In millions | 2017 | % of Total | 2016 | % of Total | % Increase (Decrease) | % Increase (Decrease) Adjusted Constant Currency (1) |
|---|---|---|---|---|---|---|
| Americas | $1,762 | 57% | $1,738 | 57% | 1% | 6% |
| Europe, Middle East Africa (EMEA) | 876 | 29% | 904 | 29% | (3)% | 6% |
| Asia Pacific (APJ) | 433 | 14% | 422 | 14% | 3% | 5% |
| Consolidated revenue | $3,071 | 100% | $3,064 | 100% | —% | 6% |

The following table shows our revenue by segment for the three months ended June 30:

| In millions | 2017 | % of Total | 2016 | % of Total | % Increase (Decrease) | % Increase (Decrease) Adjusted Constant Currency (1) |
|---|---|---|---|---|---|---|
| Software | $464 | 29% | $452 | 28% | 3% | 3% |
| Services | 588 | 37% | 574 | 35% | 2% | 4% |
| Hardware | 541 | 34% | 594 | 37% | (9)% | 1% |
| Consolidated revenue | $1,593 | 100% | $1,620 | 100% | (2)% | 3% |

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The following table shows our revenue by segment for the six months ended June 30:

| In millions | 2017 | % of Total | 2016 | % of Total | % Increase (Decrease) | % Increase (Decrease) Adjusted Constant Currency [1] |
|---|---|---|---|---|---|---|
| Software | $916 | 30% | $871 | 29% | 5% | 6% |
| Services | 1,145 | 37% | 1,117 | 36% | 3% | 4% |
| Hardware | 1,010 | 33% | 1,076 | 35% | (6)% | 7% |
| Consolidated revenue | $3,071 | 100% | $3,064 | 100% | —% | 6% |

[1] The tables above each include a presentation of period-over-period revenue growth or decline on an adjusted constant currency basis, which is a non-GAAP measure that excludes the effects of foreign currency fluctuations and the impact of the IPS divestiture. We calculate this information by translating prior period revenue growth at current period monthly average exchange rates and by excluding the prior period results of the divested IPS business for the comparable period after the completion of the sale. We believe that examining period-over-period revenue growth or decline excluding foreign currency fluctuations and adjusting for the impact of the IPS divestiture is useful for assessing the underlying performance of our business, and our management uses revenue growth adjusted for constant currency and the impact of the IPS divestiture to evaluate period-over-period operating performance. This non-GAAP measure should not be considered a substitute for, or superior to, period-over-period revenue growth under GAAP.

The following table provides a reconciliation of geographic theater revenue percentage growth (GAAP) to revenue percentage growth adjusted constant currency (non-GAAP) for the three months ended June 30, 2017:

| | Revenue % Growth (GAAP) | Favorable (unfavorable) FX impact | Divestiture impact | Revenue % Growth Adjusted Constant Currency (non-GAAP) |
|---|---|---|---|---|
| Americas | —% | —% | (3)% | 3% |
| EMEA | (5)% | (4)% | (3)% | 2% |
| APJ | —% | —% | (3)% | 3% |
| Consolidated revenue | (2)% | (2)% | (3)% | 3% |

The following table provides a reconciliation of geographic theater revenue percentage growth (GAAP) to revenue percentage growth adjusted constant currency (non-GAAP) for the six months ended June 30, 2017:

| | Revenue % Growth (GAAP) | Favorable (unfavorable) FX impact | Divestiture impact | Revenue % Growth Adjusted Constant Currency (non-GAAP) |
|---|---|---|---|---|
| Americas | 1% | —% | (5)% | 6% |
| EMEA | (3)% | (4)% | (5)% | 6% |
| APJ | 3% | 1% | (3)% | 5% |
| Consolidated revenue | —% | (1)% | (5)% | 6% |

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The following table provides a reconciliation of segment revenue percentage growth (GAAP) to revenue percentage growth adjusted constant currency (non-GAAP) for the three months ended June 30, 2017:

| | Revenue % Growth (GAAP) | Favorable (unfavorable) FX impact | Divestiture impact | Revenue % Growth Adjusted Constant Currency (non-GAAP) |
|---|---|---|---|---|
| Software | 3% | —% | —% | 3% |
| Services | 2% | (2)% | —% | 4% |
| Hardware | (9)% | (1)% | (9)% | 1% |
| Consolidated revenue | (2)% | (2)% | (3)% | 3% |

The following table provides a reconciliation of segment revenue percentage growth (GAAP) to revenue percentage growth adjusted constant currency (non-GAAP) for the six months ended June 30, 2017:

| | Revenue % Growth (GAAP) | Favorable (unfavorable) FX impact | Divestiture impact | Revenue % Growth Adjusted Constant Currency (non-GAAP) |
|---|---|---|---|---|
| Software | 5% | (1)% | —% | 6% |
| Services | 3% | (1)% | —% | 4% |
| Hardware | (6)% | —% | (13)% | 7% |
| Consolidated revenue | —% | (1)% | (5)% | 6% |

Revenue

For the three months ended June 30, 2017 compared to the three months ended June 30, 2016, revenue decreased 2% mainly due to the impact of the IPS divestiture. Excluding the impact of unfavorable foreign currency exchange rates and the IPS divestiture, revenue increased in all segments. Unfavorable foreign currency exchange rates and the IPS divestiture impacted the revenue comparison by 2% and 3%, respectively.

Software revenue increased 3% driven by growth in cloud and professional services. Services revenue increased 2% due to growth in both hardware maintenance and managed and implementation services. Hardware revenue decreased 9% due to the impact of the IPS divestiture in the prior year. In the three months ended June 30, 2016, Hardware revenue included $52 million for the IPS operations, other than MEA. Excluding the impact of the IPS divestiture and unfavorable foreign currency exchange rates, Hardware revenue increased 1% due to growth in Self-Checkout (SCO) and Point-of-Sale (POS) revenue, partially offset by declines in Automated Teller Machine (ATM) revenue.

For the six months ended June 30, 2017 compared to the six months ended June 30, 2016, revenue was flat. Excluding the impact of unfavorable foreign currency exchange rates and the IPS divestiture, revenue increased in all segments. Unfavorable foreign exchange rates and the IPS divestiture impacted the revenue comparison by 1% and 5%, respectively.

Software revenue increased 5% driven by growth in software license, cloud, and professional services. Services revenue increased 3% due to growth in both hardware maintenance and managed and implementation services. Hardware revenue decreased 6% due to the impact of the IPS divestiture in the prior year. In the six months ended June 30, 2016, Hardware revenue included $124 million for the IPS operations, other than MEA. Excluding the impact of the IPS divestiture and unfavorable foreign currency exchange rates, Hardware revenue increased 7% due to growth in SCO and POS revenue, partially offset by declines in ATM revenue.

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Gross Margin

Gross margin as a percentage of revenue in the three months ended June 30, 2017 was 29.1% compared to 27.5% in the three months ended June 30, 2016. Gross margin as a percentage of revenue expanded in our Services and Hardware segments, which reflects the results of our strategic focus on business transformation, a positive shift in revenue mix, and productivity and efficiency gains. The overall gross margin rate expansion was partially offset by a decline in our Software segment. The decline in Software gross margin rate was due to lower software license revenue partially offset by improved efficiency and scale in software maintenance and cloud.

Gross margin as a percentage of revenue in the six months ended June 30, 2017 was 28.5% compared to 27.0% in the six months ended June 30, 2016. Gross margin as a percentage of revenue expanded in our Services and Hardware segments, partially offset by a decline in our Software segment. The consolidated gross margin rate expansion was a result of our strategic focus, a positive shift in revenue mix, and productivity and efficiency gains.

Operating Expenses

Selling, general and administrative expenses were $227 million, or 14.2% as a percentage of revenue, in the three months ended June 30, 2017 as compared to $229 million, or 14.1% as a percentage of revenue, in the three months ended June 30, 2016. Selling, general and administrative expenses in the three months ended June 30, 2017 included $16 million of acquisition-related amortization of intangibles, $3 million of costs related to our business transformation initiative and $1 million of acquisition-related costs. Selling, general, and administrative expenses in the three months ended June 30, 2016 included $17 million of acquisition-related amortization of intangibles, $3 million of restructuring as well as costs related to our business transformation initiative and $1 million of acquisition-related costs. Excluding these items, selling, general and administrative expenses increased slightly from 12.8% of revenue in the three months ended June 30, 2016 to 13.0% of revenue in the three months ended June 30, 2017.

Selling, general and administrative expenses were $456 million, or 14.8% as a percentage of revenue, in the six months ended June 30, 2017 as compared to $453 million, or 14.8% as a percentage of revenue, in the six months ended June 30, 2016. Selling, general and administrative expenses in the six months ended June 30, 2017 included $32 million of acquisition-related amortization of intangibles, $7 million of costs related to our business transformation initiative and $2 million of acquisition-related costs. Selling, general, and administrative expenses in the six months ended June 30, 2016 included $33 million of acquisition-related amortization of intangibles, $5 million of restructuring as well as costs related to our business transformation initiative and $3 million of acquisition-related costs. Excluding these items, selling, general and administrative expenses increased slightly from 13.4% of revenue in the six months ended June 30, 2016 to 13.5% of revenue in the six months ended June 30, 2017.

Research and development expenses were $58 million, or 3.6% as a percentage of revenue, in the three months ended June 30, 2017 as compared to $50 million, or 3.1% as a percentage of revenue, in the three months ended June 30, 2016. Research and development expenses in the three months ended June 30, 2017 included $1 million of costs related to our business transformation initiative. Excluding this cost, research and development expenses as a percentage of revenue increased from 3.1% in the three months ended June 30, 2016 to 3.6% in the three months ended June 30, 2017. The increase in research and development expenses was driven by planned incremental investments to further advance our software and hardware solutions.

Research and development expenses were $125 million, or 4.1% as a percentage of revenue, in the six months ended June 30, 2017 as compared to $103 million, or 3.4% as a percentage of revenue, in the six months ended June 30, 2016. Research and development expenses in the six months ended June 30, 2017 included $4 million of costs related to our business transformation initiative. Excluding this cost, research and development expenses as a percentage of revenue increased from 3.4% in the six months ended June 30, 2016 to 3.9% in the six months ended June 30, 2017. The increase in research and development expenses was driven by planned incremental investments to further advance our software and hardware solutions.

In the three months ended June 30, 2017, restructuring-related charges were zero. In the three months ended June 30, 2016, restructuring-related charges were $4 million, including $3 million of other exit costs and $1 million of asset-related charges.

In the six months ended June 30, 2017, restructuring-related charges were zero. In the six months ended June 30, 2016, restructuring-related charges were $6 million, including $4 million of other exit costs and $2 million of asset-related charges.

Interest and Other Expense Items

Interest expense was $41 million in the three months ended June 30, 2017 compared to $43 million in the three months ended June 30, 2016.

Interest expense was $80 million in the six months ended June 30, 2017 compared to $89 million in the six months ended June 30, 2016. Interest expense in the six months ended June 30, 2016 included a $4 million write-off of deferred financing fees associated with the amendment of the senior secured credit facility.

Other expense, net was $7 million in the three months ended June 30, 2017 compared to $15 million in the three months ended June 30, 2016. Other expense, net in the three months ended June 30, 2017 and 2016 included $6 million and $10 million, respectively, of losses from foreign currency remeasurement and foreign exchange contracts not designated as hedging instruments.

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Other expense, net was $14 million in the six months ended June 30, 2017 compared to $25 million in the six months ended June 30, 2016. Other expense, net in the six months ended June 30, 2017 and 2016 included $10 million and $18 million, respectively, of losses from foreign currency remeasurement and foreign exchange contracts not designated as hedging instruments.

Provision for Income Taxes

Income tax provisions for interim periods are based on an estimated annual effective income tax rate calculated separately from the effect of significant, infrequent or unusual items. Income tax expense was $33 million and $31 million for the three months ended June 30, 2017 and 2016, respectively. The increase in income tax expense was driven by an increase in income from continuing operations, partially offset by an increase in discrete benefits in the three months ended June 30, 2017.

Income tax expense was $47 million and $44 million for the six months ended June 30, 2017 and 2016, respectively. The increase in income tax expense was driven by an increase in income from continuing operations, partially offset by an increase in discrete benefits in the six months ended June 30, 2017. The increase in discrete benefits was primarily driven by the recognition of excess tax benefits of stock based compensation awards in the income statement as a result of the adoption of the accounting standard related to employee share-based payments. Refer to Note 1, “Basis of Presentation and Summary of Significant Accounting Policies” for additional discussion.

The Company anticipates potential periodic volatility in future effective tax rates for the continuing impact of excess tax benefits or shortfalls resulting from stock based compensation awards. Additionally, NCR is subject to numerous federal, state and foreign tax audits. While NCR believes that appropriate reserves exist for issues that might arise from these audits, should these audits be settled, the resulting tax effect could impact the tax provision and cash flows in 2017 or future periods. The Company regularly reviews our deferred tax assets for recoverability based on the evaluation of positive and negative evidence; given current earnings and anticipated future earnings at certain subsidiaries, the Company believes that there is a reasonable possibility sufficient positive evidence may become available that would allow the release of a valuation allowance within the next twelve months.

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Income from Discontinued Operations

In the three and six months ended June 30, 2017 income from discontinued operations was $5 million, net of tax, compared to zero in the three and six months ended June 30, 2016. The increase in income from discontinued operations was driven by an insurance settlement received in the second quarter of 2017.

Revenue and Operating Income by Segment

The Company manages and reports the following three segments:

- Software - Our software portfolio includes industry-based software applications and application suites for the financial services, retail, hospitality and small business industries. We also offer other industry-oriented software applications including cash management software, video banking software, fraud and loss prevention applications, check and document imaging, remote-deposit capture and customer-facing digital banking applications for the financial services industry; and secure electronic and mobile payment solutions, sector-specific point of sale software applications, and back-office inventory and store and restaurant management applications for the retail and hospitality industries. Additionally, we provide ongoing software support and maintenance services, as well as consulting and implementation services for our software solutions.
- Services - Our global end-to-end services solutions include assessment and preparation, staging, installation, implementation, and maintenance and support for our hardware solutions. We also provide systems management and complete managed services for our product offerings. In addition, we provide servicing for third party networking products and computer hardware from select manufacturers.
- Hardware - Our hardware solutions include our suite of financial-oriented self-service ATM-related hardware, and our retail- and hospitality-oriented POS terminal and self-checkout kiosk and related hardware. We also offer other self-service kiosks, such as self-check in/out kiosks for airlines, and wayfinding solutions for buildings and campuses.

Each of these segments derives its revenue by selling in the sales regions in which NCR operates. Segments are measured for profitability by the Company’s chief operating decision maker based on revenue and segment operating income. For purposes of discussing our operating results by segment, we exclude the impact of certain non-operational items from segment operating income, consistent with the manner by which management reviews each segment, evaluates performance, and reports our segment results under GAAP. This format is useful to investors because it allows analysis and comparability of operating trends. It also
includes the same information that is used by NCR management to make decisions regarding the segments and to assess our financial performance. Our segment results are reconciled to total Company results reported under GAAP in Note 13, “Segment Information and Concentrations,” of the Notes to Condensed Consolidated Financial Statements.

In the segment discussions below, we have disclosed the impact of foreign currency fluctuations and the IPS divestiture as it relates to our segment revenue due to its significance during the quarter.

Software Segment

The following table shows the Software segment revenue and operating income for the three and six months ended June 30:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| In millions | 2017 | 2016 | 2017 | 2016 |
| Revenue | $464 | $452 | $916 | $871 |
| Operating income | $128 | $144 | $253 | $259 |
| Operating income as a percentage of revenue | 27.6 % | 31.9 % | 27.6 % | 29.7 % |

In the three months ended June 30, 2017 compared to the three months ended June 30, 2016, Software revenue increased 3%, driven by growth in cloud and professional services revenue, which were up 9% and 3%, respectively. Cloud revenue growth was due to prior period bookings and professional services revenue grew due to demand for the Company's channel transformation and digital enablement solutions. Foreign currency fluctuations did not have a significant impact on the revenue comparison.

In the six months ended June 30, 2017 compared to the six months ended June 30, 2016, Software revenue increased 5%, driven by growth in software license, up 9%, cloud, up 7%, and professional services revenue, up 4%. Software license growth was primarily due to continued demand for the Company's channel transformation solutions. Cloud revenue grew due to prior period bookings. Professional services revenue grew due to demand for the Company's channel transformation and digital enablement solutions. Foreign currency fluctuations had a 1% negative impact on the revenue comparison.

Operating income decreased in the three and six months ended June 30, 2017 compared to the three and six months ended June 30, 2016. The decrease in operating income was driven by the mix of Software revenue as well as an increase in expenses primarily related to research and development.

Services Segment

The following table shows the Services segment revenue and operating income for the three and six months ended June 30:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| In millions | 2017 | 2016 | 2017 | 2016 |
| Revenue | $588 | $574 | $1,145 | $1,117 |
| Operating income | $75 | $49 | $120 | $83 |
| Operating income as a percentage of revenue | 12.8 % | 8.5 % | 10.5 % | 7.4 % |

In the three and six months ended June 30, 2017 compared to the three and six months ended June 30, 2016, Services revenue increased 2% and 3%, respectively, driven by growth in hardware maintenance revenue as a result of improving trends for the Company's channel transformation solutions, combined with increased managed and implementation services revenue. In the three and six months ended June 30, 2017 foreign currency fluctuations had an unfavorable impact on the revenue comparison of 2% and 1%, respectively.

Operating income increased in the three and six months ended June 30, 2017 compared to the three and six months ended June 30, 2016 primarily due to business process improvement initiatives and a mix shift of higher value services.

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Hardware Segment

The following table shows the Hardware segment revenue and operating income for the three and six months ended June 30:

| | Three months ended June 30 | | Six months ended June 30 | |
|---|---|---|---|---|
| In millions | 2017 | 2016 | 2017 | 2016 |
| Revenue | $541 | $594 | $1,010 | $1,076 |
| Operating income | $12 | $14 | $2 | $4 |
| Operating income as a percentage of revenue | 2.2 % | 2.4 % | 0.2 % | 0.4 % |

In the three months ended June 30, 2017 compared to the three months ended June 30, 2016, Hardware revenue decreased 9%, driven primarily by the impact of the IPS divestiture in the prior year. In the three months ended June 30, 2016, Hardware revenue included $52 million for the results of IPS operations, other than MEA. Excluding the impact of the IPS divestiture and unfavorable foreign currency exchange rates, Hardware revenue increased due to growth in SCO and POS revenue partially offset by declines in ATM revenue. SCO and POS revenue increased due to higher demand for the Company's store transformation solutions and new product offerings. Foreign currency fluctuations and the sale of the IPS business had an unfavorable impact on the revenue comparison of 1% and 9%, respectively.

In the six months ended June 30, 2017 compared to the six months ended June 30, 2016, Hardware revenue decreased 6%, driven primarily by the impact of the IPS divestiture in the prior year. In the six months ended June 30, 2016, Hardware revenue included $124 million for the results of IPS operations, other than MEA. Excluding the impact of the IPS divestiture, Hardware revenue increased 7% due to growth in SCO and POS revenue partially offset by declines in ATM revenue. SCO and POS revenue increased due to higher demand for the Company's store transformation solutions and new product offerings. Foreign currency fluctuations and the sale of the IPS business had an unfavorable impact on the revenue comparison of zero and 13%, respectively.

Operating income declined in the three and six months ended June 30, 2017 compared to the three and six months ended June 30, 2016 driven by lower revenue.

Financial Condition, Liquidity, and Capital Resources

Cash provided by operating activities was $138 million in the six months ended June 30, 2017 compared to $144 million in the six months ended June 30, 2016. The decrease in cash provided by operating activities was due to higher working capital needs in anticipation of higher sales volume in the second half of the year.

NCR’s management uses a non-GAAP measure called “free cash flow” to assess the financial performance of the Company. We define free cash flow as net cash provided by (used in) operating activities and cash provided by (used in) discontinued operations, less capital expenditures for property, plant and equipment, less additions to capitalized software, plus discretionary pension contributions and settlements. We believe free cash flow information is useful for investors because it relates the operating cash flows from the Company’s continuing and discontinued operations to the capital that is spent to continue and improve business operations. In particular, free cash flow indicates the amount of cash available after capital expenditures for, among other things, investments in the Company’s existing businesses, strategic acquisitions, repurchases of NCR stock and repayment of debt obligations. Free cash flow does not represent the residual cash flow available for discretionary expenditures, since there may be other non-discretionary expenditures that are not deducted from the measure. Free cash flow does not have a uniform definition under GAAP, and therefore NCR’s definition may differ from other companies’ definitions of this measure. This non-GAAP measure should not be considered a substitute for, or superior to, cash flows from operating activities under GAAP. The table below reconciles net cash provided by operating activities to NCR’s non-GAAP measure of free cash flow for the six months ended June 30:

| | Six months ended June 30 | |
|---|---|---|
| In millions | 2017 | 2016 |
| Net cash provided by operating activities | $138 | $144 |
| Less: Expenditures for property, plant and equipment | (43) | (24) |
| Less: Additions to capitalized software | (84) | (74) |
| Net cash used in discontinued operations | (5) | (20) |
| Free cash flow (non-GAAP) | $6 | $26 |

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The increase in expenditures for property, plant and equipment was primarily due to tenant improvements in our new world headquarters, a majority of which are reimbursed by the lessor and included in net cash provided by operating activities. The change in cash flows from discontinued operations from the prior year was due to decreased litigation payments related to the Fox River and Kalamazoo River environmental matters as well as an insurance settlement received in the second quarter of 2017.

Financing activities and certain other investing activities are not included in our calculation of free cash flow. Other investing activities primarily include business acquisitions, divestitures and investments as well as proceeds from the sale of property, plant and equipment.

Our financing activities primarily include proceeds from employee stock plans, repurchases of NCR common stock and borrowings and repayments of credit facilities and notes. During the six months ended June 30, 2017 and 2016, we repurchased a total of $350 million and $250 million, respectively, of our common stock. During the six months ended June 30, 2017 and 2016, proceeds from employee stock plans were $8 million and $6 million, respectively. During the six months ended June 30, 2017 and 2016, we paid $24 million and $7 million, respectively, of tax withholding payments on behalf of employees for stock based awards that vested.

Long Term Borrowings  As of June 30, 2017, our senior secured credit facility consisted of a term loan facility with an aggregate outstanding principal balance of $844 million, and a revolving credit facility in an aggregate principal amount of $1.1 billion, of which $40 million was outstanding. Additionally, the revolving credit facility has up to $400 million available to certain foreign subsidiaries. Loans under the revolving credit facility are available in U.S. Dollars, Euros and Pound Sterling. The revolving credit facility also allows a portion of the availability to be used for outstanding letters of credit, and as of June 30, 2017, there were no letters of credit outstanding. As of December 31, 2016, the outstanding principal balance of the term loan facility was $866 million and the outstanding balance on the revolving facility was zero.

As of June 30, 2017 and December 31, 2016, we had outstanding $700 million in aggregate principal balance of 6.375% senior unsecured notes due in 2023, $600 million in aggregate principal balance of 5.00% senior unsecured notes due in 2022, $500 million in aggregate principal balance of 4.625% senior unsecured notes due in 2021 and $400 million in aggregate principal balance of 5.875% senior unsecured notes due in 2021.

Our revolving trade receivables securitization facility provides the Company with up to $200 million in funding based on the availability of eligible receivables and other customary factors and conditions. As of June 30, 2017 and December 31, 2016, the Company had $200 million and zero, respectively, outstanding under the facility.

Employee Benefit Plans In 2017, we expect to make contributions of $30 million to our international pension plans, $55 million to our postemployment plan and $3 million to our postretirement plan. For additional information, refer to Note 6, “Employee Benefit Plans,” of the Notes to the Condensed Consolidated Financial Statements.

Restructuring Program In July 2014, we announced a restructuring plan to strategically reallocate resources so that we can focus on higher-growth, higher-margin opportunities in the software-driven consumer transaction technologies industry and as of March 31, 2017, this plan was complete. Refer to Note 15, "Restructuring Plan," of the Notes to the Condensed Consolidated Financial Statements for additional discussion on our restructuring plan.

However, we remain focused on continuing our transformation by improving sales execution, increasing customer services productivity and loyalty, making software our business and optimizing our cost structure. We may identify additional restructuring activities as we operationalize the transformation initiatives.

Series A Convertible Preferred Stock On December 4, 2015, NCR issued 820,000 shares of Series A Convertible Preferred Stock to certain entities affiliated with the Blackstone Group L.P. for an aggregate purchase price of $820 million, or $1,000 per share, pursuant to an Investment Agreement between the Company and Blackstone, dated November 11, 2015. In connection with the issuance of the Series A Convertible Preferred Stock, the Company incurred direct and incremental expenses of $26 million. These direct and incremental expenses reduced the Series A Convertible Preferred Stock, and will be accreted through retained earnings as a deemed dividend from the date of issuance through the first possible known redemption date, March 16, 2024. Holders of Series A Convertible Preferred Stock are entitled to a cumulative dividend at the rate of 5.5% per annum, payable quarterly in arrears. During the three months ended June 30, 2017 and 2016, the Company paid dividends-in-kind of $11 million, respectively, associated with the Series A Convertible Preferred Stock. During the six months ended June 30, 2017 and 2016, the Company paid dividends-in-kind of $23 million, respectively, associated with the Series A Convertible Preferred Stock. As of June 30, 2017 and December 31, 2016, the Company had accrued dividends of $3 million, respectively, associated with the Series A Convertible Preferred Stock. There were no cash dividends declared during the three and six months ended June 30, 2017 or 2016.

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The Series A Convertible Preferred Stock is convertible at the option of the holders at any time into shares of common stock at a conversion price of $30.00 per share, or a conversion rate of 33.333 shares of common stock per share of Series A Convertible Preferred Stock.

Under the Investment Agreement, Blackstone agreed not to sell or otherwise transfer its shares of Series A Convertible Preferred Stock (or any shares of common stock issued upon conversion thereof) without the Company’s consent until June 4, 2017. In March 2017, we provided Blackstone with an early release from this lock-up, allowing Blackstone to sell approximately 49% of its shares of Series A Convertible Preferred Stock, and in return, Blackstone agreed to amend the Investment Agreement to extend the lock-up on the remaining 51% of its shares of Series A Convertible Preferred Stock for six months until December 1, 2017.

In connection with the early release of the lock-up, Blackstone offered for sale 342,000 shares of Series A Convertible Preferred Stock in an underwritten public offering. In addition, Blackstone converted 90,000 shares of Series A Convertible Preferred Stock into shares of our common stock and we repurchased those shares of common stock for $48.47 per share. The underwritten offering and the stock repurchase were consummated on March 17, 2017.

As of June 30, 2017 and December 31, 2016, the maximum number of common shares that could be required to be issued upon conversion of the outstanding shares of the Series A Convertible Preferred Stock was 26.7 million and 29.0 million shares, respectively.

Cash and Cash Equivalents Held by Foreign Subsidiaries Cash and cash equivalents held by the Company's foreign subsidiaries at June 30, 2017 and December 31, 2016 were $358 million and $428 million, respectively. Under current tax laws and regulations, if cash and cash equivalents and short-term investments held outside the U.S. are distributed to the U.S. in the form of dividends or otherwise, we may be subject to additional U.S. income taxes and foreign withholding taxes, which could be significant.

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Summary As of June 30, 2017, our cash and cash equivalents totaled $377 million and our total debt was $3.28 billion. As of June 30, 2017, our borrowing capacity under the revolving credit facility was approximately $1.1 billion, and under our trade receivables securitization facility was zero, as it was fully drawn. Our ability to generate positive cash flows from operations is dependent on general economic conditions, competitive pressures, and other business and risk factors described in Item 1A of Part I of the Company’s 2016 Annual Report on Form 10-K and Item 1A of Part II of this Quarterly Report on Form 10-Q. If we are unable to generate sufficient cash flows from operations, or otherwise comply with the terms of our credit facilities or senior unsecured notes, we may be required to seek additional financing alternatives.

We believe that we have sufficient liquidity based on our current cash position, cash flows from operations and existing financing to meet our required pension, postemployment, and postretirement plan contributions, remediation and other payments related to the Fox River and Kalamazoo River environmental matters, debt servicing obligations, and our operating requirements for the next twelve months.

Contractual and Other Commercial Commitments

Since the filing of our 2016 Form 10-K, there have been no significant changes in our contractual and other commercial obligations, other than an increase of approximately $57 million related to a new lease agreement signed in Europe. The lease term is expected to commence in 2019, with projected cash payments of approximately $3 million in 2019, $11 million in 2020-2021 and $43 million in 2022 and thereafter.

The Company’s uncertain tax positions are not expected to have a significant impact on liquidity or sources and uses of capital resources. Our product warranties are discussed in Note 7, "Commitments and Contingencies," of the Notes to Condensed Consolidated Financial Statements.

Critical Accounting Policies and Estimates

As described in Note 1, “Basis of Presentation and Summary of Significant Accounting Policies,” of the Notes to Condensed Consolidated Financial Statements, we adopted an accounting standard update for share-based compensation effective January 1, 2017. Accordingly, we now record excess tax benefits resulting from stock based awards to employees in the Condensed Consolidated Statements of Operations, at the time the awards vest, as a component of the provision for income taxes. Additionally, our Condensed Consolidated Statements of Cash Flows will present excess tax benefits, if any, as an operating activity.

Management reassessed the critical accounting policies as disclosed in our 2016 Form 10-K and determined that, other than the change in accounting for share-based compensation, there were no changes to our critical accounting policies in the six months ended June 30, 2017. Also, there were no significant changes in our estimates associated with those policies.

New Accounting Pronouncements

See discussion in Note 1, “Basis of Presentation and Summary of Significant Accounting Policies” of the Notes to Condensed Consolidated Financial Statements for new accounting pronouncements.

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Forward-Looking Statements

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements use words such as “expect,” “anticipate,” “outlook,” “intend,” “believe,” “will,” “should,” “would,” “could” and words of similar meaning. Statements that describe or relate to NCR’s plans, goals, intentions, strategies or financial outlook, and statements that do not relate to historical or current fact, are examples of forward-looking statements. Forward-looking statements are based on our current beliefs, expectations and assumptions, which may not prove to be accurate, and involve a number of known and unknown risks and uncertainties, many of which are out of NCR's control. Forward-looking statements are not guarantees of future performance, and there are a number of important factors that could cause actual outcomes and results to differ materially from the results contemplated by such forward-looking statements, including those factors relating to: the strength of demand for ATMs and other financial services hardware; domestic and global economic and credit conditions including, in particular, those resulting from uncertainty in the "BRIC" economies, economic sanctions against Russia, the determination by Britain to exit the European Union, the potential for changes to global or regional trade agreements or the imposition of protectionist trade policies, and the imposition of import or export tariffs or border adjustments; the impact of our indebtedness and its terms on our financial and operating activities; the impact of the terms of our strategic relationship with Blackstone and our Series A Convertible Preferred Stock; the transformation of our business model and our ability to sell higher-margin software and services; the possibility of disruptions in or problems with our data center hosting facilities; cybersecurity risks and compliance with data privacy and protection requirements; foreign currency fluctuations; our ability to successfully introduce new solutions and compete in the information technology industry; our ability to improve execution in our sales and services organizations; defects or errors in our products; manufacturing disruptions; collectability difficulties in subcontracting relationships in Emerging Industries; the historical seasonality of our sales; the availability and success of acquisitions, divestitures and alliances, including the divestiture of our Interactive Printer Solutions business; our pension strategy and underfunded pension obligation; the success of our restructuring plans and cost reduction initiatives; tax rates; reliance on third party suppliers; development and protection of intellectual property; workforce turnover and the ability to attract and retain skilled employees; environmental exposures from our historical and ongoing manufacturing activities; and uncertainties with regard to regulations, lawsuits, claims and other matters across various jurisdictions. Additional information concerning these and other factors can be found in the Company's filings with the U.S. Securities and Exchange Commission, including the Company’s most recent annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. Any forward-looking statement speaks only as of the date on which it is made. The Company does not undertake any obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Information About NCR

NCR encourages investors to visit its web site (http://www.ncr.com) which is updated regularly with financial and other important information about NCR. The contents of the Company’s web site are not incorporated into this quarterly report or the Company’s other filings with the U.S. Securities and Exchange Commission.

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

We are exposed to market risks primarily from changes in foreign currency exchange rates and interest rates. It is our policy to manage our foreign exchange exposure and debt structure in order to manage capital costs, control financial risks and maintain financial flexibility over the long term. In managing market risks, we employ derivatives according to documented policies and procedures, including foreign currency contracts and interest rate swaps. We do not use derivatives for trading or speculative purposes.

Foreign Exchange Risk

Since a substantial portion of our operations and revenue occur outside the United States, and in currencies other than the U.S. Dollar, our results can be significantly impacted by changes in foreign currency exchange rates. We have exposure to approximately 50 functional currencies and are exposed to foreign currency exchange risk with respect to our sales, profits and assets and liabilities denominated in currencies other than the U.S. Dollar. Although we use financial instruments to hedge certain foreign currency risks, we are not fully protected against foreign currency fluctuations and our reported results of operations could be affected by changes in foreign currency exchange rates. To manage our exposures and mitigate the impact of currency fluctuations on the operations of our foreign subsidiaries, we hedge our main transactional exposures through the use of foreign exchange forward and option contracts. These foreign exchange contracts are designated as highly effective cash flow hedges. This is primarily done through the hedging of foreign currency denominated inter-company inventory purchases by the marketing units. All of these transactions are forecasted. We also use derivatives not designated as hedging instruments consisting primarily of forward contracts to hedge foreign currency denominated balance sheet exposures. For these derivatives we recognize gains and losses in the same period as the remeasurement losses and gains of the related foreign currency-denominated exposures.

We utilize non-exchange traded financial instruments, such as foreign exchange forward and option contracts, that we purchase exclusively from highly rated financial institutions. We record these contracts on our balance sheet at fair market value based upon market price quotations from the financial institutions. We do not enter into non-exchange traded contracts that require the use of fair value estimation techniques, but if we did, they could have a material impact on our financial results.

For purposes of analyzing potential risk, we use sensitivity analysis to quantify potential impacts that market rate changes may have on the fair values of our hedge portfolio related to firmly committed or forecasted transactions. The sensitivity analysis represents the hypothetical changes in value of the hedge position and does not reflect the related gain or loss on the forecasted underlying transaction. A 10% appreciation or depreciation in the value of the U.S. Dollar against foreign currencies from the prevailing market rates would have resulted in a corresponding increase or decrease of $11 million as of June 30, 2017 in the fair value of the hedge portfolio. The Company expects that any increase or decrease in the fair value of the portfolio would be substantially offset by increases or decreases in the underlying exposures being hedged.

The U.S. Dollar was stronger in the second quarter of 2017 compared to the second quarter of 2016 based on comparable weighted averages for our functional currencies. This had an unfavorable impact of 2% on second quarter 2017 revenue versus second quarter 2016 revenue. This excludes the effects of our hedging activities and, therefore, does not reflect the actual impact of fluctuations in exchange rates on our operating income.

Interest Rate Risk

We are subject to interest rate risk principally in relation to variable-rate debt. Approximately 67% of our borrowings were on a fixed rate basis as of June 30, 2017. The increase in pre-tax interest expense for the six months ended June 30, 2017 from a hypothetical 100 basis point increase in variable interest rates would be approximately $6 million.

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Concentrations of Credit Risk

We are potentially subject to concentrations of credit risk on accounts receivable and financial instruments, such as hedging instruments and cash and cash equivalents. Credit risk includes the risk of nonperformance by counterparties. The maximum potential loss may exceed the amount recognized on the balance sheet. Exposure to credit risk is managed through credit approvals, credit limits, selecting major international financial institutions (as counterparties to hedging transactions) and monitoring procedures. Our business often involves large transactions with customers for which we do not require collateral. If one or more of those customers were to default in its obligations under applicable contractual arrangements, we could be exposed to potentially significant losses. Moreover, a prolonged downturn in the global economy could have an adverse impact on the ability of our customers to pay their obligations on a timely basis. We believe that the reserves for potential losses are adequate. As of June 30, 2017, we did not have any significant concentration of credit risk related to financial instruments.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

NCR has established disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (the Exchange Act)) to provide reasonable assurance that information required to be disclosed by NCR in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to provide reasonable assurance that information required to be disclosed by NCR in the reports that it files or submits under the Exchange Act is accumulated and communicated to NCR’s management, including its Chief Executive and Chief Financial Officers, as appropriate to allow timely decisions regarding required disclosure. Based on their evaluation as of the end of the second quarter of 2017, conducted under their supervision and with the participation of management, the Company’s Chief Executive and Chief Financial Officers have concluded that NCR’s disclosure controls and procedures are effective to meet such objectives and that NCR’s disclosure controls and procedures adequately alert them on a timely basis to material information relating to the Company (including its consolidated subsidiaries) required to be included in NCR’s Exchange Act filings.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the three months ended June 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 1. LEGAL PROCEEDINGS

The information required by this item is included in Note 7, "Commitments and Contingencies," of the Notes to Condensed Consolidated Financial Statements in this quarterly report and is incorporated herein by reference.

Item 1A. RISK FACTORS

There have been no material changes to the risk factors previously disclosed in Part I, Item IA ("Risk Factors") of the Company's 2016 Annual Report on Form 10-K.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On October 19, 2016, the Board approved a share repurchase program, with no expiration from the date of authorization, for the systematic repurchase of the Company’s common stock to offset the dilutive effects of the Company’s employee stock purchase plan, equity awards and in-kind dividends on the Company’s Series A Convertible Preferred Stock. Availability under this program accrues quarterly based on the average value of dilutive issuances during the quarter.

On March 12, 2017, the Board approved a second share repurchase program that provides for the repurchase of up to $300 million of the Company’s common stock.

No shares were repurchased under these programs during the three months ended June 30, 2017.

As of June 30, 2017, $300 million was available for repurchases under the March 2017 program, and approximately $143 million was available for repurchases under the October 2016 dilution offset program. The timing and amount of repurchases under these programs depend upon market conditions and may be made from time to time in open market purchases, privately negotiated transactions, accelerated stock repurchase programs, issuer self-tender offers or otherwise. The repurchases will be made in compliance with applicable securities laws and may be discontinued at any time.

The Company occasionally purchases vested restricted stock or exercised stock options at the current market price to cover withholding taxes. For the three months ended June 30, 2017, 28,032 shares were purchased at an average price of $43.04 per share.

The Company’s ability to repurchase its common stock is restricted under the Company’s senior secured credit facility and terms of the indentures for the Company’s senior unsecured notes, which prohibit certain share repurchases, including during the occurrence of an event of default, and establish limits on the amount that the Company is permitted to allocate to share repurchases and other restricted payments. The limitations are calculated using formulas based generally on 50% of the Company’s consolidated net income for the period beginning in the third quarter of 2012 through the end of the most recently ended fiscal quarter, subject to certain other adjustments and deductions, with certain prescribed minimums. These formulas are described in greater detail in the Company’s senior secured credit facility and the indentures for the Company’s senior unsecured notes, each of which is filed with the SEC.

Item 6. EXHIBITS

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| 2.1 | Separation and Distribution Agreement, dated as of August 27, 2007, between NCR Corporation and Teradata Corporation (Exhibit 10.1 to the Current Report on Form 8-K of Teradata Corporation dated September 6, 2007). |

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| 3.1 | Articles of Amendment and Restatement of NCR Corporation (incorporated by reference to Exhibit 3.1 to the Quarterly Report on Form 10-Q of NCR Corporation for the quarter ended June 30, 2016). |
| 3.2 | Bylaws of NCR Corporation, as amended and restated on October 11, 2016 (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K of NCR Corporation dated October 11, 2016). |
| 4.1 | Common Stock Certificate of NCR Corporation (incorporated by reference to Exhibit 4.1 from the NCR Corporation Annual Report on Form 10-K for the year ended December 31, 1999). |
| 4.2 | Indenture, dated September 17, 2012, among NCR Corporation, as issuer, NCR International Inc. and Radiant Systems Inc. as subsidiary guarantors and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.01 to the Current Report on Form 8-K of NCR Corporation dated September 17, 2012). |
| 4.3 | Indenture, dated December 18, 2012, among NCR Corporation, as issuer, NCR International Inc. and Radiant Systems Inc. as subsidiary guarantors and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.01 to the Current Report on Form 8-K of NCR Corporation filed December 18, 2012). |
| 4.4 | Indenture, dated December 19, 2013, between NCR Escrow Corp. and U.S. Bank National Association relating to the $400 million aggregate principal amount of 5.875% senior notes due 2021 (the "5.875% Notes") (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of NCR Corporation dated December 19, 2013 (the "December 19, 2013 Form 8-K")). |
| 4.5 | First Supplemental Indenture relating to the 5.875% Notes, dated January 10, 2014, among NCR Corporation, NCR International, Inc. and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K of NCR Corporation dated January 10, 2014 (the "January 10, 2014 Form 8-K")). |
| 4.6 | Indenture, dated December 19, 2013, between NCR Escrow Corp. and U.S. Bank National Association relating to the $700 million aggregate principal amount of 6.375% senior notes due 2023 (the "6.375% Notes") (incorporated by reference to Exhibit 4.2 to the December 19, 2013 Form 8-K). |
| 4.7 | First Supplemental Indenture relating to the 6.375% Notes, dated January 10, 2014, among NCR Corporation, NCR International, Inc. and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.2 to the January 10, 2014 Form 8-K). |
| 10.1 | Form of 2017 Director Restricted Stock Unit Grant Statement under the NCR Corporation 2013 Stock Incentive Plan (the "2013 Stock Incentive Plan") and NCR Corporation 2017 Stock Incentive Plan (the "2017 Stock Incentive Plan"). |
| 10.2 | Form of 2017 Stock Option Award Agreement under the 2013 Stock Incentive Plan and 2017 Stock Incentive Plan. |
| 31.1 | Certification pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934. |
| 31.2 | Certification pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934. |
| 32 | Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101 | Financials in XBRL Format. |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

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| | | NCR CORPORATION | |
| Date: | July 28, 2017 | By: | /s/ Robert Fishman |
| | | | Robert Fishman |
| | | | Executive Vice President and Chief Financial Officer |