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COMPANY INTERVIEW

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Waytronx, Inc.

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Waytronx, Inc. (WYNX)



WILLIAM CLOUGH is President and CEO of Waytronx, Inc. He previously served as Executive Vice President for two years, during which time he spearheaded the research and development of the company's WayCool™ Technology, including the HydroJet licensing agreement with major customers like OCZ Technology Group, Inc. Before joining Waytronx, Mr. Clough, an attorney and former law enforcement officer, operated his own law firm for 14 years, representing leading movie studios and media conglomerates with offices in Los Angeles, San Francisco and Honolulu. Mr. Clough received his J.D. "cum laude" from Hastings College of the Law in 1990.

SECTOR – SEMICONDUCTORS

(ANB634) **TWST: Would you give us a historical sketch of the company and bring us up to the present?**

Mr. Clough: Waytronx became a public company about eight or nine years ago. It was started in 1999 as a media company that concentrated on signage. Over the course of the next several years, it became involved with an inventor who had developed a relatively unique method of presenting LED signage. When I became involved with the company about five years ago, it was primarily engaged in the LED signage business. The inventor actually had invented a very unique method of cooling LED crystals which allowed the signage to be able to be put in a very unique format that was very lightweight and very portable.

In getting into the company with my partner, Brad Hallock, who is now the Senior Vice President in charge of Corporate Development, we recognized the fact that the company's cooling technology was actually much more vibrant than we initially realized and that it had applications beyond LED, particularly in the microprocessor space, where heat was becoming a huge issue.

Over the course of the next several years, we were able to acquire the entire patent portfolio, which is known as WayCool/WayFast. In the meantime, both Brad and I went from investors to becoming more involved with the company. I'm an attorney, and I became General Counsel for the company. I ultimately took over as President and CEO; and Brad became a Director and then moved into his current position.

During this course of time, we took the company from the LED signage business into the R&D, pure technology business of developing the WayCool technology. About two years ago, in conjunction with the development of that technology, we were introduced to a little company called CUI, based in Tualatin, Ore. We recognized CUI as being a very efficient, very effective distributor and seller of electronic components. We also recognized that it could provide an incredible platform for us to move not just the WayCool and WayFast technologies into the marketplace, but also other leading-edge technologies into the marketplace; and we began negotiating to purchase CUI. We culminated that purchase in May of last year, and since then I

have set about integrating CUI into Waytronx, using its infrastructure and expertise in customer service, logistics and Internet presentations, and its cash flow to acquire and commercialize new technologies. So this brings us to the present.

TWST: You acquired the patent portfolio from the inventor who developed the LED technology cooling system.

Mr. Clough: Yes, that's right.

TWST: Would you tell us more about the products, infrastructure and capabilities that came with the CUI acquisition?

Mr. Clough: As far as the product line is concerned, approximately 60% of CUI's business is in external and internal power supply. External refers to the type of power supply that plugs into a laptop computer. It's the big box that you plug into your laptop. It also can be the charger that you plug into your cell phone — what's known in the industry as "wall warts." These are the external power supplies. Internal power supplies are the power supplies you find in a television set or a DVD player which provide power to the individual components within the box. So that's the product line.

But more importantly, what we got from our acquisition of CUI is an incredibly efficient and effective customer service and logistics group that literally is able to deliver product anywhere on Earth within 48 hours. CUI prides itself on an incredibly unique Internet presence. We are the only provider of electronic components that already has all of our SKUs — that's over 2,000 SKUs — 3D modeled on our Web site. We continue to target design engineers, as we always have. We invite those engineers to come to our Web site, which does for them what they have to do themselves on most other Web sites. At other Web sites, they have to take the specifications for a part and build their own models to put into their design modeling system. At our Web site, we do all this for them. We literally have put all of our SKUs into a 3D modeling system that can interface with any current design engineering platform on the market today. In addition to that, we have an engineering team led by our CTO, a gentleman by the name of Duwang Li, a Ph.D. from China who provides unique and really individualized customization to the design engineers we target. They literally will take our parts, at the request of the design engineers, and remake them or revise them in any way necessary to get into the product stream to

the OEMs and the various customers that we have. So that's the infrastructure we brought on board when we acquired CUI.

TWST: Would you tell us about Waytronx's products?

Mr. Clough: Let me talk first about the technology, which is still in the development stage. The technology, quite simply, is a very, very efficient method of moving intensely high degrees of energy — heat, in essence — away from the source. We believe that its most effective application is going to be in 3D chipsets, the things that, for example, IBM is working on right now. It's where you stack high-end, high-energy chips, one on top of the other, to create economies of scale. The problem with those chipsets, as described by IBM, is that they are like little "nuclear reactors," they create a huge amount of energy in a very small package. Our WayCool technology is a solution for moving that energy away from the source. It's still under development, and we are working with a number of different entities — not the least of which is BAE, the North American division of British Aerospace — to develop and implement it in a commercialized fashion. Above and beyond that, if you've checked out our press releases over the last several months, you will have seen that we've been acquiring other technologies that are already in the market or much closer to coming to market. These include an encoder packet called the C14 encoder. It's, in essence, a low-priced, very competitive encoder device that we have introduced into the market. We are selling it to many of our medical device customers and others that need a device to, in essence, translate motion into computer language. So the turning of a dial or the pushing of a button is translated by the C14 encoder into computer language.

The other product that we are currently bringing to market is the AMT encoder. It's a really unique product — an encoder that is both scalable and able to address a variety of different-sized electric motors.

"Our number one goal is to grow annual revenues to more than \$100 million by 2013."

TWST: This product has received design wins, correct?

Mr. Clough: Correct. It has received several design wins, the biggest of which is from MicroMo, the North American division of Faulhaber Group, one of the largest DC motor manufacturers in the world. They like it because they have, as an example, well over 2,000 SKUs. They currently need close to 1,500 encoders to fit on all their different motors. We are able to give them one encoder that, because it is scalable, will fit on almost all of those 2,000 motors. So you can see the advantage there.

On Monday, August 10, we announced the signing of a licensing agreement with GL Industrial Services, one of the largest energy consultants in the world. What we have licensed from them is a product called GasPT2 that we are very excited about. The contract calls for about \$35 million to \$40 million in revenues over the first four years. It is the first device of its kind that will

actually monitor the quality and quantity of natural gas, real time, in the pipeline. This is a very dramatic difference from what we currently do. There is no method by which real-time analysis of natural gas in a pipeline can be done right now. So this is another product that we are going to be marketing worldwide. The announcement was made Monday morning.

TWST: Did you want to mention any other products?

Mr. Clough: The core products that CUI had when we actually came on board are the ones I mentioned — the internal and external power supplies. They also do a pretty vibrant business in motion control devices — things like encoders other than the C14 and AMT. Finally, there is another business segment that makes buzzers and warning devices. Interestingly enough, most of those are for use in golf carts. We do a number of backup warning buzzers that, if you play golf, you hear when you put the golf cart in reverse. Oftentimes those are our buzzers in there. And then we do some cable assemblies, which in essence amount to customized assemblies that selected OEMs might ask us to do where they want a cord or a packet of cords at a certain length that's unique to their devices and their products. But this is a very small part of our business.

TWST: Most of your products have their own end markets?

Mr. Clough: Yes, and almost all of our products are actually branded by somebody else. In other words, we might build a power supply for Dell or a charger for Verizon that is sold in to the market under their brand. Our products often go out as part of another device. For example, we do the encoders for Philips Medical sonograms. That's a very large business for us. But obviously no one would know that because the encoders are internal to the sonogram, wherever they are built. That's actually a good example of a design win. If you look at the Philips process, it took us almost 18 months to get our encoders into their sonograms. Here is how it went: Philips put out bids; a lot of companies responded; we sent them our encoders; they looked at them, came back, and said, "These are good." They put them in a test device, came back to us and said, "Hey, these are great, we really like the way they perform, but we have one problem: The doctors don't like the way they feel. Can you fix that?" Well, fixing the way something feels is rather a difficult task. We spent literally the next several months sending them different tensions and getting the feel just right, and we finally won the contract. It took almost 18 months to get that design win. But once you get it, there is almost no way to lose it. We have designed something that they are very happy with, that "feels right." It's almost impossible for someone to take that business away from us. That's the real advantage of what we do.

TWST: Who are your customers?

Mr. Clough: We have over 2,500 different customers encompassing a very broad spectrum. A significant portion of our distribution is through DigiKey — the fourth-largest distributor of electronic components in the world. DigiKey is setting up an encoder portal that will look like its own, but is actually going to be run by us. The company has a huge online catalog for electronic components, and 38 pages of that catalog consist of our products. Obviously, we sell to thousands of end users through that catalog. DigiKey runs the portal and from the customer's perspective, the product comes from DigiKey. But it is actually our business model

that is running that small portion of DigiKey's operation.

Our other customers are the OEMs. We provide power supplies to Verizon, and a number of tier-2 and tier-3 telecom companies. We are just getting into the digital power market, and we expect to be seeking customers along the lines of Juniper and Google.

TWST: What kind of growth have you been achieving?

Mr. Clough: We are seeing relatively good growth now, despite the current market. We have just reported our second-quarter earnings. We did total gross revenues last year of \$19.5 million. Our EBITDA was about \$2.5 million. We just reported results for the first half of this year. We reported \$12.5 million in revenues and about \$1.2 million in EBITDA. For the full year we expect gross revenues to be around \$26 million, with EBITDA between \$2.5 million and \$2.75 million.

TWST: What are your strategic goals and objectives going forward?

Mr. Clough: I think our number one goal is to grow annual revenues to more than \$100 million by 2013. To achieve this goal we're aggressively seeking new technologies and new products to introduce into the market.

Another important goal is to move to a pure technology licensing business model. The acquisition of CUI's customer service, logistics, infrastructure and cash flow has put us in a good position to become a very strong licensing business model. We can get new technologies and bring them to the market quickly, effectively and economically. Using our various distribution channels, we are ready to attack a variety of different markets with a variety of different products.

The last strategic goal that we expect to achieve in the next couple of years is to move our stock off the Bulletin Board to a national exchange like the NASDAQ Capital Market.

TWST: Can you explain your use of the term "licensing business model?"

Mr. Clough: I'm talking, in essence, about being the person or entity that is licensing the products. GL's GasPT is a good example. We own the exclusive licensing rights. We are exclusively manufacturing, marketing, selling and distributing that product to the gas industry worldwide, and we're paying a royalty, or licensing fee, to GL Industrial Services. So this is the kind of the thing I'm talking about. We want to take products from companies, such as GL Industrial Services — which has some 85 protected patents and a vested interest in seeing the products brought to market in the right way — who do not want to manufacture or market the products themselves. We would like to use our infrastructure to quickly, efficiently and economically get the products into the marketplace.

On the other hand, we also acquire pure technology, as we did with WayCool and WayFast. We now own the patents on these technologies, and we feel we can market and distribute them. So when I talk about a technology licensing model, I'm really talking about acquiring technology, either through the purchase of a patent portfolio or through the licensing of patented technology and then taking it to market.

TWST: What challenges do you face in implementing your strategic plans?

Mr. Clough: I think we face the challenges that all companies face to some extent in this economic environment. We

need to continue to focus on identifying products that meet our customers' needs. We need to continue to focus on providing services to our customers that they don't get or can't get anywhere else. And we need to keep an eye on our expenses to make sure that we run our operations in an efficient, cost-effective way. I think these are the same challenges that everybody faces now. I think the days of inflated stock prices and free money are gone. You now have to be efficient and effective to have cash flow and to be in a position where you can go after available technology that fits into your business model. You have to have the bandwidth to commercialize the product and get it to market. So those are the challenges that we're facing. It really means keeping our eyes open, keeping our hands on our cash flow and making sure that we're using it the right way.

"We're aggressively seeking new technologies and new products to introduce to the market."

TWST: Have you taken steps to reduce your cost structure?

Mr. Clough: We're constantly doing that. We're constantly looking at what we do and making sure it's as efficient as possible. For example, we recently expanded our sales force vertically. We brought in a very capable executive to serve as Vice President of Worldwide Sales. This executive has taken our existing internal sales force and expanded it to six manufacturer rep organizations. This has given us a total of 60-plus sales executives on the ground covering almost all of North America, including Canada and parts of Mexico where we had never had a presence before. We're doing this on a purely commission basis, which is costing us little or nothing until sales are actually made.

I should also mention to you that based on our corporate philosophy we are taking a certain percentage of all sales that are made by these organizations and putting them back into what we believe are valuable and worthwhile causes, from providing food and clothes to homeless people to supporting different causes that we and our manufacturing rep organizations care about and feel are worthwhile.

TWST: So you have an ongoing philanthropic program?

Mr. Clough: Yes, we try to provide 10% of our net profits back to the community. We provide scholarships to certain local colleges, support for youth groups, food and clothing to homeless shelters both in Portland and throughout the state of Oregon.

TWST: Has this always been part of your corporate philosophy?

Mr. Clough: It was part of the philosophy of CUI when we became involved with the company, and it was one of the things the former owner really insisted on when we purchased the company from him. He insisted the philosophy remain unchanged. We were happy to agree to this; we have

continued the philanthropic programs, and we will continue to do so for the foreseeable future.

TWST: Looking forward, how much of your growth will be organic and how much will come from acquisitions?

Mr. Clough: It would be fair to say it probably will be about a 50-50 mix. We think that organic growth will probably account for 50% or even 60% of our overall growth. We think we're going to see a lot of organic growth from our AMT encoder and our entry into the digital power market.

But we also expect the products we've already acquired — especially the GasPT2 product, which we believe is going to be very valuable — to be an important driver of our growth. And as I mentioned, we are keeping our eyes open. We are small and nimble enough that, unlike most big companies that have kind of drawn in their R&D budgets over the course of the last 18 months because of the economy, we've been able to expand and grab up technologies that might not have been available to a company our size in the past. So we expect to continue doing that, and we think probably 40% to 50% of our growth will come from new technologies that we acquire.

“We actually make money, which is a kind of nice unique thing for a company in today’s difficult economy.”

TWST: How have you been able to finance these acquisitions so far?

Mr. Clough: In a couple of different ways. One is cash flow. We actually make money, which is a kind of nice unique thing for a company in today's difficult economy. The other is that we have a very strong supporting group of shareholders who've been with the company for a long time. Many are very wealthy and have been able to provide us with funding when necessary to get some of the bigger acquisitions that we've made.

TWST: How would you characterize this type of financing? Is it private equity?

Mr. Clough: It's definitely private equity. That's exactly the right term.

TWST: So they are, in return, receiving shares in the company?

Mr. Clough: Correct.

TWST: Do you have very strong balance sheet?

Mr. Clough: We created a large amount of debt when we acquired CUI. It's interesting because the debt is primarily held by the previous owner who was and is a very cooperative seller. His son and daughter-in-law are key executives with the company. And he obviously has a deep and long-term relationship with the company. So while we have a large amount of debt on our books, it's very “friendly” debt, and we have the cash flow necessary to do what we need to do. So from that perspective, our balance sheet is

as strong as we need it to be.

TWST: I haven't asked you about your competitors. I suspect this varies across your product line?

Mr. Clough: You're exactly right. Our competition is very product and industry specific. For example, in our power supply business, our biggest domestic competitors are companies like Power-One and Emerson; internationally, Phihong is a major competitor. Our connectors business competes with Hirose in Japan, which is the giant in the industry, Molex and EMP. Our encoders face competition from Avago in the modular world, and Alps and Grayhill in the panel mount world. And as I mentioned, our C14 encoder competes directly with Grayhill's encoder.

TWST: How has your business been impacted by the economic crisis and credit crunch?

Mr. Clough: The economic crisis has not had a big impact on our company. The reason is that we're small enough that we haven't had the deep cuts and deep losses that bigger companies have experienced; yet we are big enough to have the cash flow and support to be able to continue our business largely unaffected by the broader economic downturn. I hate to say that because, knock on wood, that's the first time you'll find yourself affected by it. But really we have not found ourselves in a position to date where we've had a problem with credit lines, where we've had the kind of issues that many companies are facing. In fact, for us the recession has created an opportunity. As I mentioned to you, we're able to go out and grab up technologies because of our cash flow and technology platform.

TWST: In terms of obtaining the financing that you need to fund your growth, the credit crunch has not made a difference?

Mr. Clough: No, it has not. It has not made a big difference for us.

TWST: Because you have your own network of investors?

Mr. Clough: That, and because we have the cash flow.

TWST: What's the best metric to use to for obtaining an understanding of the cash flow you have to reinvest? Is it your gross margin?

Mr. Clough: I think gross margin probably is the best. The thing that really differentiates us from a lot of other companies in this space is that we take no business with less than a 40% gross margin. This historically is the way CUI operated. We are very adamant with our sales group and with our rep organizations, and we've been able to do this even in these economic times. I think it's largely a result of the ancillary services we provide that people just can't get from other companies.

TWST: So you are able to achieve high gross margins because your services are custom tailored?

Mr. Clough: Exactly.

TWST: Or is it high demand for your products?

Mr. Clough: No, the products largely are commodity products. It's exactly what you said. We custom design our services, and we are literally going after the design engineers — the people who are designing these products at the outset. These are the people we're catering to. We're giving them both the Internet support and the actual engineering support that they need and that they can't get elsewhere.

TWST: So you produce the product for them? Is that right?

Mr. Clough: The component. It's usually a component of their product.

TWST: What milestones should investors focus on in gauging your progress towards achieving your strategic goals?

Mr. Clough: I think the best gauge of how we are doing is to look at what we've done over the last several months and to look at the line of products we've acquired. They've been announced and there was an announcement on Monday. Investors also can follow our products in the marketplace, and they should monitor the impact of our AMT encoder and GasPT product on the marketplace, and on our revenues. We strongly believe these new products will ramp up our revenues over the next few years. So monitoring our

revenue growth is the best method of gauging how we're doing and what we should be doing to move this business forward.

TWST: Thank you. (LKS)

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