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Profire Energy, Inc.

Second Quarter 2023 Earnings Call

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Jim McIlree, *Dawson James Securities*

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John Bair, *Ascend Wealth Advisors*

PRESENTATION

Operator

Good morning, everyone, and thank you for participating in today's conference call to discuss Profire Energy's Quarterly Operating and Financial Performance for the period ended June 30, 2023.

I will now turn the call over to John Beisler, Investor Relations Consultant at Three-Part Advisors, to get the call started. Please go ahead.

John Beisler

Thank you, Operator.

With me on the call today is Co-CEO and CFO of Profire Energy, Ryan Oviatt; and Co-CEO, Cameron Tidball.

Yesterday, after the market closed, the Company filed its Form 10-Q with the SEC and discussed the quarter's highlights in the press release. As always, both of those documents are available on the Investors section of the Company's website. A transcript of this call will be posted in the coming days.

Before we begin today's call, I would like to take a moment to read the Company's Safe Harbor statement. Statements made during this call that are not historical are forward-looking statements. This call contains forward-looking statements, including but not limited to, statements regarding the Company's expected growth, revenue diversification, product availability, industry efforts in the production of clean energy, growth in our customer base in the natural gas market, inventory balances, potential acquisition opportunities, the availability of Company resources to make beneficial investments in 2023 and into 2024 and the Company's future financial performance. All such forward-looking statements are subject to uncertainty and changes in circumstances.

Forward-looking statements are not guarantees of future results or performance and involve risks, assumptions, and uncertainties that could cause actual events or results to differ materially from the events or results described in or anticipated by the forward-looking statements. Factors that could materially affect such forward-looking statements include certain economic, business, public market, and regulatory risk factors identified in the Company's periodic reports filed with the Securities and Exchange Commission.

All forward-looking statements are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. All forward-looking statements are made only as of the date of this release, and the Company assumes no obligation to update forward-looking statements to reflect subsequent events or circumstances, except as required by law. Readers should not place undue reliance on these forward-looking statements.

I would like to remind everyone that this call is being recorded and will be available for replay through August 24, 2023, starting later today. It will be accessible via the link provided in yesterday's press Release, as well as through the Company's website at profireenergy.com. Following the remarks by Mr. Oviatt and Tidball, we will open the call for your questions.

Now I would like to turn the call over to the Co-CEO and CFO of Profire Energy, Mr. Ryan Oviatt. Ryan, please go ahead.

Ryan Oviatt

Thank you, John, and welcome to all of you who are joining us on the call today.

Our second quarter 2023 results reflect a sustained momentum across our business. We recorded our fourth consecutive quarter of revenue in excess of $12 million and posted our highest-ever quarterly net income and EBITDA. The last six-month and 12-month periods represent the best-ever consecutive six and 12-month periods in Company history. We are excited about the path we are on and our ability to continue to operate at these record-setting levels.

We are a much better and stronger Company today than we were when we last achieved this level of quarterly revenues, profits, and cash flows. We have more products to offer, our customer base is larger, our technology keeps getting better and better, and we believe the outlook for our business is strong for the next several years.

This quarter's performance is a result of a number of strategic actions taken over the past 12 to 18 months, including strategic staffing efforts, investments in revenue diversification initiatives, inventory management in response to supply chain issues, and pricing initiatives to offset inflationary pressures.

As we have previously stated, we believe hydrocarbons will continue to play a significant role in global energy requirements for the foreseeable future. Recently, multiple LNG projects have been announced that will add billions of cubic feet of capacity. S&P expects global demand for LNG to increase more than 50% over the next decade. EQT, one of our top customers for the past several years, is the U.S.'s largest natural gas producer and is one of the major players in the LNG production space. We subscribe to their mantra that, "unleashing U.S. LNG and replacing international coal with American natural gas is the largest green initiative on the planet and the world's best weapon to address climate change".

They state so eloquently, there is a great opportunity to help the climate and to meet our own and the rest of the world's energy needs through the clean production of U.S. natural gas. The world continues to demand more energy in all of its forms, not less. The recent upward moves in crude oil and natural gas prices in July are a tailwind to our business, particularly as E&P companies continue their focus on maintenance that has been deferred for many years as well as invest in improved efficiency and ESG initiatives.

The EIA's short-term energy forecast for July shows a reversal of their same forecast at the start of the year as it relates to oil prices. The forecast now shows prices increasing for the next 18 months into the $80s, even though we have already surpassed that in the month of July alone. Similarly, their natural gas forecast continues to show prices getting back to the mid to upper $3 range. These forecasts, combined with the capital discipline being demonstrated by U.S. and Canadian exploration and production companies, is part of what gives us confidence in the strength and resilience of the oil and gas industry for the next several years.

With that, let me turn my remarks to Profire's financial results for the second quarter of 2023. During the second quarter, we recognized $14.4 million in revenue compared to $14.6 million in the first quarter and $9.6 million in the prior year quarter. Typically, revenue for the second quarter declined sequentially as oil and gas activity slowed entering the summer months and resulting from the spring breakup cycle in Canada. For comparison, in the two years prior to the pandemic, second quarter revenue decreases were approximately 7% compared to the first quarter. The year-over-year increase was primarily driven by ongoing customer demand, pricing initiatives, and continued progress across our strategic diversification efforts.

Gross profit for the second quarter was $7.4 million compared to $7.8 million in the prior quarter and $4.4 million in the second quarter of 2022. Gross margin was 51.3% of revenues compared to 53.8% in the prior quarter and 45.7% in the second quarter of 2022. The sequential decrease is primarily related to the product and customer mix, while the year-over-year increase was the result of the greater fixed-cost coverage from higher revenues, price increases, as well as typical fluctuations in inventory and warranty reserves.

Total operating expenses for the second quarter were approximately $4.2 million compared to $4.5 million in the first quarter and $4.3 million in the year-ago quarter. The sequential and year-over-year decreases reflect the non-recurring recognition of the second half of an employee retention tax credit available through the CARES Act, which more than offset the impact of headcount additions and overall cost inflation across the business.

Net income for the second quarter was approximately $2.9 million, or $0.06 per diluted share. This compares to net income of $2.6 million, or $0.05 per diluted share in the first quarter of 2023 and net income of $284,000, or $0.01 per diluted share in the second quarter of last year.

Cash flow from operations in the second quarter was approximately $1.3 million compared to $1.8 million in the prior-year quarter. Our working capital balances are strong and have the ability to continue to generate positive cash flows for our business in the coming quarters. We continue to monitor these balances and work to optimize them where possible in the challenging supply chain environment we have to operate under. Our inventory balance at the end of the quarter was approximately $13 million compared to $10.6 million at the end of the first quarter.

Our efforts over the past six to 12 months to procure the product and components necessary for our solutions is starting to pay off, although there are still issues with sourcing and quality from certain suppliers. We continue to think long-term and are already working with our suppliers to ensure we will have the necessary product for 2024 to support our customer demand. As noted above, we are optimistic about the second half of 2023 and 2024, thanks to the strength of our legacy business, our diversification efforts, and our robust sales pipeline.

We ended the quarter with $17.4 million in cash and liquid investments and remained debt-free. Late in the quarter, we were able to begin repurchasing stock under our previously approved and announced share repurchase program. We repurchased approximately 47,000 shares of our stock in the period. We continue to evaluate opportunities to use our cash beyond the share repurchase program, including increases to our sales and marketing spend, allocating additional resources to product development, and potential acquisition opportunities.

With that, I will now turn the call over to Cam to provide an overview of our business. Cam?

Cameron Tidball

Thank you, Ryan.

Q2's performance represented our second-best top-line revenue quarter in the last 12 months and, as Ryan mentioned, ranks amongst our best results in Company history. Our team continues to deliver strong financial performance as a result of consistent operational execution and focused delivery of an excellent product with superior customer experience.

Our customer-centric team and culture remains focused on our strategic initiatives. Support and attention to our traditional legacy business, coupled with strategic development of diversified revenue streams within the energy industry, as well as new industries, remains paramount to our strategy.

This consistent focus throughout the organization guides our sales and marketing strategies, as well as our product and business development process. Commodity prices, drilling and completion activity, as well as our customers' ESG initiatives, impact Profire's revenue in the upstream and midstream energy segments.

In the quarter, WTI averaged $73 per barrel, slightly below Q1's average of $76 per barrel. Natural gas prices averaged $2.16 in the quarter versus $2.64 in quarter one. Drill count in Q2 averaged 815 versus Q1 average of 977. U.S. completion activity declined with a monthly average of 1,013 in Q2, while Q1 averaged 1,101.

Despite the softening of some of these industry metrics, our business remains steady due to customers continuing their focus on internal ESG goals related to improving emissions, increasing automation, and lowering overall carbon footprint. Profire products and solutions play a significant role in lowering the requirement for gas-driven pneumatic devices, increasing combustion efficiency of heated appliances, maximizing uptime of equipment that ensures destruction of volatile organic compounds, and decreasing the necessity for site visits from operators. All of these factors contribute to the reduction of greenhouse gas and methane emissions at our customers' operations.

Profire technology supports the clean and efficient production of crude oil and better positions producers to develop and provide affordable, reliable, clean natural gas, which we believe to be one of the globe's most impactful tools to support the world's current and future energy requirements.

We continue to support upstream and midstream customers such as EQT, Chesapeake, Chevron, Conoco, Oxy, CNRL, and many more as they bring on new production, retrofit existing pads and fields, as well as seek opportunities to increase efficiency and lower emissions as they continue to produce the valuable resources critical to a reliable energy infrastructure.

In the quarter, we continued to gain momentum with our proprietary burner technology, which is being used by a major producer in Canada to achieve significant reductions in the amount of fuel gas required onsite by as much as 35%, thus drastically lowering the burden and impact of Federal carbon taxes on their business, as well as a reduction in their CO2 emissions. We continue to demonstrate that our solutions can help customers increase efficiency, thus lowering their overall emissions and operating costs.

In the quarter, we commenced a project with a major producer in the Permian Basin, which could lead to significant upgrade opportunities stemming from our expertise in optimizing combustion efficiency of heated appliances. Our proven experience in supporting our customers in dealing with operational challenges related to emissions efficiency and protection of human life and assets continues to elevate Profire's reputation as the leading provider of burner and combustion management solutions.

Our success in the upstream and midstream business leverages into the downstream utility and natural gas transmission markets. We enable operators in this space to achieve safety, automation, and appliance efficiency. Our customer base is supported by valued distribution partners, as well as direct end-user relationships. We continue to develop this area of our business with our existing sales force and through efforts to expand our partner and distribution network.

As part of our diversification strategy, revenue generation in critical energy infrastructure continues to grow. This space is characterized by applications that perform critical functions related to the treating, processing, NGL fractionation, storage, and transmission. Customers such as Kinder Morgan, Enterprise Products, Williams, TC Energy, Energy Transfer, MPLX, AltaGas and DCP Midstream represent a small sample of the customers we are working with to support new construction, as well as retrofit activity.

In Q2, we saw an increase in projects delivered and the associated revenue, coupled with some exciting bids with existing and new customers for future projects. We believe this momentum will enable us to achieve our annual revenue targets in this diversified space.

Turning to our diversification progress in non-oil and gas and industrial markets. As expected and communicated previously, our progress from a revenue recognition and project win perspective has been inconsistent on a quarterly basis. Sales and project cycles in this space are longer than our traditional legacy business.

Despite our results to date, we remain extremely encouraged by the quantity of projects we are bidding, the volume of purchase orders received, as well as our sales pipeline. In the quarter, we installed and commissioned projects related to food and beverage production, managing vented hydrogen supply at a lithium battery factory, incineration of biogas at a renewables landfill, critical amine reboilers utilized at waste management landfills, as well as maintenance and support at a pulp and paper mill.

We also continue to find and receive new opportunities for projects from repeat customers. Profire continues to gain traction with renewable natural gas producers who collaborate with landfills to take biogas and transform it into pipeline quality renewable natural gas. We see this area as a growing market for Profire and an area where our technology and expertise are easily leveraged.

On our Q1 call, we mentioned that we were invited to scope and assess potential upgrades for thermal appliances at a small batch refinery. We are excited to report that we have been awarded a purchase order to conduct an engineering feed study, which we believe could result in formal bids to retrofit several heaters within the refinery.

Towards the end of Q2, we began talks with a leading provider of steam reforming gasification systems that are used at state-of-the-art integrated bio refinery facilities. Since our initial discussions, we have submitted a proposal to support applications which take biomass material and transform it into jet fuel. We have been shortlisted and believe that we have a strong chance to win this project, which will again add to our growing list of applications that we can support with our technology and solutions.

Revenue diversification in oil and gas, as well as in new industries, remains a critical area of focus for Profire. We continue to invest resources in support of our growing customer and application base. We remain optimistic that we can continue to attract new customers, partners, and applications with our technology, solutions, products, process, design, and support. We are confident that our brand and value proposition and reputation as a leading provider of industrial burner and combustion management solutions and technologies will continue to increase. Our research and development investment remains critical to our future.

We continue to employ a strategically balanced approach to short, mid, and long-term product development and research. We continue to place time and energy on the investigation of accretive acquisitions. Our strategy remains intact to pursue opportunities that will help us in smart and strategic growth.

Before we turn to questions, Ryan and I thank you individually for your interest in and support of Profire. To our team, thank you for your contributions to supporting our customers, our business, and our team. What you do each day makes a difference to the safety of our customers, the protection and efficiency of their equipment, and the protection of our environment.

Operator, would you please provide the appropriate instructions so we can get the Q&A started?

Operator

Of course.

(Operator Instructions)

The first question comes from Jim McIlree with Dawson James. Please go ahead.

Ryan Oviatt

Good morning, Jim.

Jim McIlree

Yes, thanks. Good morning. Hey, guys. In your commentary, I was a little bit confused. It seemed like you were pointing to certain aspects of the market that would suggest either a slowing or a peaking out of growth, but other parts you seem to be much more bullish. I'm just hoping you could maybe characterize what you're seeing in the market right now. Are you seeing any weakness or any pullback from your customers?

Ryan Oviatt

Yes, good question, Jim. I'll let Cam comment as well on this. But it's the crazy market that we're in, right? There are signs that show both positive and potential pullback. I know the broader economy, we still talk about whether or not a recession will happen. Some believe we're past it. Some believe it's still coming. We're of the opinion, and hopefully our prepared remarks indicated at least some of this, that despite any of the short-term movements up or down which we've talked about Q1 to Q2 July's results, we think the longer term over the next one to two years that the oil and gas market is going to remain strong, that there is upward movement, that natural gas is going to continue to be a major need just like I mentioned about EQT and their view of American natural gas and LNG and the potential that the U.S. has there with that and we certainly believe that.

We buy into that message and that our customers are going to continue to benefit from those types of movements in the market. Yes, we do see some of that shorter term quarter-to-quarter volatility up and down. That does have an impact on our business. We did try to also highlight that even though the movements in some of those metrics were larger Q1 to Q2, it didn't have as big of an impact on our business because of a lot of the strategic things we're doing, but also because of the effort that our customers continue to demonstrate their discipline in how they're investing in their businesses right now. Cam, anything you want to add to that?

Cameron Tidball

Yes. The only thing I'd add to that, Ryan, is the fact that our customers, the sentiment is still the same. They're focused on making their Shareholders money, not at ensuring stability in supply and demand—on the supply side in energy markets in the United States and Canada. But when it comes down to it, again, as Ryan mentioned, some of the metrics softened slightly but even since the end of Q2 we've obviously seen an increase in oil price; natural gas price, we believe is going to go up.

All these things help us, but again, the underlying tone of what Profire's products and solutions do for our customers, we're seeing this deferred maintenance, deferred capital allocation to automation strategies, moving to more efficiency to avoid carbon taxes in the Canadian market. All these things are perfect for Profire's solutions to come in and support and help. We still feel very optimistic about things despite some of the metrics softening obviously to a larger degree than our revenue in the last quarter.

Jim McIlree

Ryan, you talked about the quarter-to-quarter change in this year is much stronger than it was prior to the pandemic. Is there a chance that maybe some of your customers were pulling in orders in order to avoid a price increase or they're looking at inventory issues as well? Is there a little bit of a potential that customers were ordering now for fear of what might be coming in the second half?

Ryan Oviatt

Cam, do you want to take that one?

Cameron Tidball

Our pipeline right now is very strong, meaning, the orders that we've taken that we haven't delivered on. There definitely is the idea out there and we've planted it, we've planted it back even prior to 2022 is that the orders need to be in, in order to ensure that product is there and available. We thought we'd see more of a spike at the end of last year to avoid price increase, but I think customers just believe it's going to happen.

You see it more from resellers and OEMs than you do end users. Any of our clients and customers that stock inventory and things like that, you saw a little bit of it. But for the most part we've seen a little bit of more of a normal behavior now, but customers are still ordering out further in advance than they had in previous years by far.

Jim McIlree

Okay. Thank you. My last question is on the inventory and receivable balances. I know you've been working hard to bring these down, but it just seems to be very difficult. I'm wondering if maybe we—I should stop expecting those balances to come down and maybe that's just the cost of being in business right now is to have those high receivable and inventory balances.

Ryan Oviatt

Yes, good question. It's certainly something that's on our minds and we continue to monitor. I would probably characterize our actions as of late and even up until now more about trying to make sure we have enough product than strictly on bringing the balances down, still coming out of the supply chain challenges related to COVID and the pandemic.

We've been and have to order parts sometimes at least a year in advance in order to ensure that we will have it when we need it, when our customers want it. Even then we still have a backlog of orders. That's where the focus has been. We are seeing things continue to get a little bit better every day in that regard, but there's still, as I mentioned, a ways to go. We still have some quality issues and availability issues with certain customers.

From an inventory perspective, I'm optimistic that it will come down. Is that going to come down next quarter? I can't guarantee that. We're still looking at what do we need to have on hand. What do we need to have on order for 2024 to get us through that time frame? We still have a lot that is on order and there are some timing challenges of when that's going to come in, when it's going to be available.

Specifically in Q2 a lot of the product that we put on order in Q4 of last year was finally starting to flow in a consistent manner. That's been part of that increase of just over $2 million in inventory that we saw in Q2. We also continue to have the dynamic of the eventual shift from our 2100 product to our 2200 product. The 2200 components and systems have been much harder to get over the last year and a half than the 2100. We've been building inventory on both of those.

Then the switching is a challenge, because we can't go back and forth with a customer. We can't sell them 2100s today, 2200s next week and then switch them back to 2100s after that. They don't really like that behavior. We have been building a bit more supply on the 2200 side. Now that we've got that we can start switching customers over and know that we'll be able to continue to supply them with those newer systems going forward. There are a number of dynamics in there.

Over the longer term, I would say over the next 12 to 18 months, we certainly want to be bringing those balances down. But we also care more about making sure we have the product on hand to sell to our customers than the reverse of running out.

On the AR side, some of that is timing as well. Even within the quarter we see some lumpiness in the months and that's been with some of the labor challenges that we've had. We've had some turnover here and there in the warehouses and then had to restaff mid-quarter, and then also the timing of when products coming in during the quarter. In this last quarter we had a lot more product available in June than we did in April, and so we were able to ship more out. That just means that flows later into AR in the quarter than if it were smooth every month. Again, just some timing issues, largely. I think AR will be able to come down sooner than inventory will, but that's how we're viewing it, how we're looking at it.

Jim McIlree

That's great. Thanks a lot, guys. That's it for me.

Cameron Tidball

Thanks, Jim.

Operator

The next question comes from Rob Brown with Lake Street Capital Markets. Please go ahead.

Ryan Oviatt

Hey, Rob.

Rob Brown

Good morning, Cam and Ryan. Just wanted to follow-up on the pricing changes that you've made. Is that fully now implemented in end results or is there still more to go there in terms of what you see in terms of margin?

Ryan Oviatt

Cam, do you want to tackle that one?

Cameron Tidball

Yes, you bet. Yes, fully implemented, obviously the 2023 price changes. But with that being said, some of our resale products and even some of our proprietary products, if there is a change in our ability to procure the prices, they continue to fluctuate, we pass those along to the customer. We've been able to hold our own proprietary products for the most part for the year, but we've had some of those that we have to move here and there. But it's well expected that we will be looking at price increases for 2024 year as well. It's just the way it is and nobody's business is becoming less costly to run. It's only more cost and it has to go somewhere.

But for the most, really, we've been able to implement across. We don't have any old outstanding orders really of any substance that are still on old pricing.

Rob Brown

Okay. Then, in terms of where you're at in terms of diversification of revenue, I think your goal was 10% plus, but where is that at today?

Cameron Tidball

On the critical energy infrastructure side, or what we've called in the past the downsides of Midstream or downstream of Midstream, we're ahead of target for ourselves. The internal targets we set for and goals that we set for ourselves, we're doing very well there. In terms of revenue recognition, as per the remarks on the call, in non-oil and gas, we're behind where we'd like to be. However, we're still on track to do better than last year, but the sales orders we brought in exceed where we were last year, so we'll definitely have an increase in the ability to hit.

We're still potentially in that realm to be able to hit that 10%, but what we're really encouraged about is just the number of bids and the opportunities and the breadth of solutions that we're being invited to participate because of reputation that's growing. The OEMs that we've supported on some projects last year, the year before, and into this year, they're taking that further. Those OEMs often deal in multiple industries, so we're getting lots of great traction there. We're starting to see a little bit more coming from the chemical side as we've invested time and talent into that space.

As I mentioned on the call here earlier, we're really excited about one of the opportunities we have in that regasification market. Again, it's a renewable space. It's something that has been proven, and there's a global footprint and appetite for that, which could help expand our products. We're working with an OEM in that space. We're working direct with end user in that space, as well as engineering firm, all within the last six months, we've started those discussions and now into project bids. Behind on the overall on that stated target of 10%, still within reach, still progressing nicely and very optimistic about where we're going with the amount of bids that are out there in terms of a dollar value and quantity.

Ryan Oviatt

I would add to that. Those jobs are sizable. It doesn't take a lot of those wins to help us re-move that needle as well. We are, as Cam said, very excited about the size and the number of opportunities still in front of us and the likelihood that we should be able to achieve them.

Rob Brown

Okay. Great. Thank you. I'll turn it over.

Ryan Oviatt

Thanks, Rob.

Operator

(Operator Instructions)

The next question comes from John Bair with Ascend Wealth Advisors. Please go ahead.

Ryan Oviatt

Good morning, John.

John Bair

Good morning. Can you hear me? Hello?

Ryan Oviatt

We hear you.

Cameron Tidball

Yes, we got you, John.

Ryan Oviatt

Operator, John? Operator? Seems we're having some technical difficulties. Everyone hold on and the Operator will help us there.

Operator

There are no more questions in the queue. I would like to hand the call back to Management for closing remarks.

Cameron Tidball

Thanks, everyone, for joining us on our call today, and thank all of you for your continued support. As always, we're available for any discussions or questions you might have. Also, we will be participating at the Three-Part Advisors IDEAS Conference in Chicago on August 23 and the Lake Street Investor Conference in New York on September 14. Thank you, everyone, and have a great day.

Operator

This concludes today's conference call. You may disconnect your lines. Thank you for participating, and have a pleasant day.