



Profire Energy, Inc.

Year-End 2019 Earnings Conference Call

March 12, 2020

C O R P O R A T E P A R T I C I P A N T S

Brenton Hatch, *Chairman, Chief Executive Officer & President*

Ryan Oviatt, *Chief Financial Officer, Secretary, Treasurer & Director*

Cameron Tidball, *Chief Business Development Officer*

Jay Fugal, *Vice President, Operations*

C O N F E R E N C E C A L L P A R T I C I P A N T S

Robert Brown, *Lake Street Capital Markets*

John White, *Roth Capital Partners*

Samir Patel, *Askeladden Capital Management*

P R E S E N T A T I O N

Operator

Good afternoon, everyone, and thank you for participating in today's conference call to discuss Profire Energy's fourth quarter and Fiscal Year 2019 ended December 31, 2019. Joining us today is the CEO of Profire Energy, Brenton Hatch; and CFO of Profire Energy, Ryan Oviatt.

Before we begin today's call, I would like to take a moment to read the Company's Safe Harbor statement, cautionary note regarding forward-looking statements. 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 operating expenses, international market, the availability of Company's resources to make beneficial investments in 2020 and beyond, the successful integration of acquired assets 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 now like to remind everyone that this call is being recorded and will be available for replay through March 26, 2020, starting later this evening. It will be accessible via the link provided in yesterday's press release as well as the Company's website at www.profireenergy.com.

Following the remarks by Mr. Hatch and Mr. Oviatt, we will open the call to your questions. As part of the question-and-answer session, Mr. Hatch and Mr. Oviatt will be joined by Profire's Chief Business Development Officer, Cameron Tidball; Profire Energy's Vice President of Operations, Jay Fugal; and Vice President of Product Development, Patrick Fisher.

I would now like to turn the call over to Chief Executive Officer of Profire Energy, Mr. Brenton Hatch. Please go ahead.

Brenton Hatch

Thank you, and welcome, everyone, to our fourth quarter and full year 2019 earnings call for Profire Energy. I am pleased with the accomplishments we are making internally and our present position, given the current market environment. Although this progress has not fully transpired into the financials due to the turmoil in our industry, I want to update you on the things that continue to set Profire apart.

At the end of 2018, we announced our strategic investment plan for 2019 that included focused investment on product development, international expansion and M&A activity. These investments are proving valuable for us as we achieved a number of our strategic objectives in 2019. These included the acquisition and integration of Midflow and Millstream obtaining SIL certification and initiating sales of our PF2200, and again, achieving full year profitability. We managed to accomplish this while generating cash from operating activities and maintaining our debt-free balance sheet.

Twenty-Twenty has presented us a number of challenges, including the continued volatility of the oil and gas market, which has been exaggerated by the spread of the coronavirus and other global conditions. This, of course, is placing additional pressure on oil prices, which, in part, have continued to limit the amount of capital expenditures being made by exploration and production companies as they shift their focus to cost management and allocating their cash flows towards such things as debt reduction and share repurchases.

I am confident that our cash position, coupled with our cash flow generation and discipline, will allow us to manage through this volatile period and position us to take advantage of opportunities to grow our Company.

Before I get into our plans for 2020, I'd like to turn the call over to Ryan for a review of our 2019 results.

Ryan Oviatt

Thanks, Brent.

Yesterday, after the market closed, we filed our 10-K with the SEC and discussed the year's highlights in a press release. As always, both of those documents are available on the Investors section of our website. The transcript of this call will be posted in the coming days.

For the full year 2019, we recognized \$39 million in revenue, which is down 14.5% from the same period a year ago, primarily driven by the ongoing downturn in volatility of the oil and gas industry. This is

evidenced by the fact that the average oil price and the average onshore rig count were both down 13% year-over-year. Indications from our sales force are that our customer cap ex budgets were down even more significantly than these industry metrics.

Gross profit decreased to \$19.5 million as compared to \$22.9 million in the prior year. Gross margin remained flat at 50.1% of revenues compared to 50.2% in the prior year. The typical fluctuations of gross profit margin are driven by changes in product mix and inventory and warranty reserves.

Total expenses were approximately \$16.4 million or a 9.6% increase from last year. This increase is primarily due to an increase in employee-related expenses and professional fees related to the two acquisitions that were completed during the year and to other costs to further strategic initiatives. This was an expected increase as we continued to execute strategic investments as part of our growth plan, although we intentionally didn't allow the cost structure to increase by as much as we originally signaled at the beginning of 2019.

Operating expenses for G&A increased approximately 3%. R&D increased 38% and depreciation and amortization increased 95% as compared to the previous year. The increase in R&D was driven by ongoing development of the PF2200 product line, which began initial commercial sales in December 2019. The increase in depreciation and amortization was a result of additional fixed assets and intangible assets recognized through the acquisitions.

Further, part of the increase in amortization expense was the full write-off of the patent associated with the CMS product line. CMS sales continued to be insufficient to justify retaining the value of the patent on the balance sheet any longer.

Total other income during the period was \$403,000, the majority of which was attributable to interest on investments and the sale of fixed assets.

Net income for the year was \$2 million or \$0.04 per diluted share compared to net income of \$6.1 million or \$0.12 per diluted share in the prior year. Net income was also impacted by two one-off unusual items, which were the additional CMS product and patent write-down of \$525,000, and the de-recognition of tax loss carryforwards in Canada, with a potential tax benefit of approximately \$685,000.

Tax losses in Canada have been fully applied against previous tax payments and can be carried forward for 20 years from the year in which they were generated. However, because current projections show a likelihood of further losses in Canada for the short term, we have been unable to retain these future tax benefits on the balance sheet. We will continue to explore tax planning strategies that will hopefully allow us to recognize these benefits well before they expire in 18 to 20 years. If it had not been for these two one-off items, our net income and earnings per share would have been significantly higher.

In the fourth quarter, we recognized \$8.1 million in revenue, which is down 23% from the same period a year ago and 18% from Q3. The average oil price in Q4 2019 was down 5% compared to the average of Q4 2018, while the onshore rig count was down 24% over the same period.

The net loss for the fourth quarter was \$1.3 million or \$0.03 per diluted share compared to net income of \$831,000 or \$0.02 per diluted share in the same quarter last year. As stated previously, when discussing the full year performance, these figures were impacted by the one-off items recorded in Q4 related to CMS product write-downs and de-recognition of tax loss carryforwards in Canada.

Now let's look at the balance sheet.

Cash and liquid investments totaled \$18.6 million as compared to \$22.6 million at the end of 2018. The \$4 million decrease reflects our 2019 cash flow from operations and changes in working capital balances of \$7.6 million, offset by \$4.4 million spent on M&A, \$4.7 million on a new building in Canada and \$2.7 million pursuant to our share repurchase program. Our significant cash reserve allows us flexibility in responding to changing market conditions.

We remain debt-free. We own outright the majority of our facilities we operate from as well as the trucks and equipment used to run our business. We have historically carried a large amount of inventory due to the long lead time nature of many of our products or the components necessary to build our products. This strong balance sheet position provides us even further flexibility in times of volatility and uncertainty.

Throughout 2019 and even in the first quarter of 2020, E&P companies have continued to focus more on capital discipline like debt reduction, dividends and share buybacks than they ever have done historically. This typically means less cash available for exploration and cap ex expansion. As a result of the ongoing macro trends, we believe many E&Ps have pulled back on cap ex budgets and may continue to restrict cap ex spending throughout 2020.

As we move forward in 2020 with confidence in Profire's long-term outlook, we will continue efforts to control spending and maintain the capital discipline that has served us so well for many years. We will continue to look for strategic opportunities to provide value to shareholders, which might include additional M&A opportunities or additional share repurchases among other strategic activities.

I will now turn the call back over to Brent.

Brenton Hatch

Thanks, Ryan.

We are pleased to report that Profire's 2019 strategic priorities and investments have received positive validation from our market and new and existing customers. Profire continues to be an organization that collaborates with and responds to our customers' needs and requirements. This philosophy is at the core of our business development strategy.

In 2019, our R&D team continued development of the 2200 and in the fourth quarter, we began sales and marketing initiatives. We have received very positive feedback and response to the features and benefits of our latest BMS controller. Receiving SIL certification on the 2200 was a monumental achievement in 2019. This certification process is never easy and requires patience and diligence. The 2200 is our next-generation BMS controller and platform that will eventually replace our current 2100 family of BMS controllers. The 2200 has been designed to be an open platform, which will potentially enable expansion of alternative control systems in the future, offering us flexibility and shortened development times.

Profire continues to solidify our position as a market leader in the upstream and midstream burner management space. Our 3100 product offering has opened doors to facilities, projects and applications that our previous product line couldn't. In 2019, we increased our 3100 project revenue, even though total company revenue decreased. We are proud of this performance, given our customers' lower cap ex spend throughout the fiscal year. Profire believes that the 3100 will be key to our continued expansion of the downstream market.

As previously reported, in 2019 we completed the asset purchase of Millstream Energy Products based out of Alberta, Canada. Due to this acquisition, we have continued to add accretive products that our existing sales team can market and sell. This acquisition has expanded our offering of combustion-related products, solutions and expertise. The equity purchase of Midflow Services, LCC based out of Ohio, has

increased our presence in the Northeastern U.S. Retention of Midflow's team members was paramount to Profire in completing this transaction. We are pleased to report that integration initiatives have been successful and we are now operating as one team. The assimilation of these two acquisitions in 2019 was a heavy undertaking for our team. We are proud to report that integration, though difficult, has been largely successful. We are now a one-stop shop for burner management systems.

In 2019, we continue to work our multiyear investment plan in building out our international sales and distribution channels. As we have reported previously, Profire products can be found in oil and gas applications throughout the world. In 2019, we continued to solidify relationships with suitable distribution partners.

Efforts to quantify and qualify markets and strategic partners were the prime focus of our international business development team. We look to 2020 as the year where we will continue to build these relationships, provide training and support to our distributors and their customers as they focus on sales and marketing initiatives. Thus far, most of our international distribution sales have been realized in South America and Asia.

As you are aware, very few are immune to the economic disruptions related to the coronavirus. Just prior to the outbreak, which resulted in significant manufacturing delays, Profire received a shipment of a significant quantity of MEP product that we believe will satisfy market demand until factories supplying our product return to full capacity. The inventory on hand allows us to respond quickly to customer needs, which, over the years, has distinguished Profire from its competition.

As global commodity prices have declined sharply in recent days, we plan to respond accordingly and continue to focus on capital discipline. We are monitoring the situation closely and retain the flexibility to adjust our budget, if needed.

We are optimistic about the future because of our business principles that allowed us to advance during the last industry downturn and can now be duplicated. The strength of our balance sheet allows us to look and build to the future. While many of our competitors may be forced into holding patterns or selling assets, our financial position allows us to build on the investments in 2019 while being financially prudent.

Thank you.

And we will now open the call to questions. Operator, please provide the appropriate instructions so that we can get the Q&A started.

Operator

Thank you. If you would like to ask a question please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment it may be necessary to pick up your handset before pressing the star keys. For the question-and-answer portion of this call please keep questions limited to one primary question and one follow-up question.

Our first question comes from the line of Rob Brown with Lake Street Capital Markets. Please proceed with your question.

Robert Brown

Just kind of a question on the outlook, which I realize is a little hard to predict at this point. But what's sort of the latest you're hearing from your customers in terms of the demand environment? And maybe how they're reacting to the commodity price change here?

Brenton Hatch

Well, Rob, I'm not supposed to use that kind of language on air, so I'll maybe write down an e-mail to you. It's not pretty in general terms. But Cam, you have more face-to-face interaction with some of our customers. Can you speak to that one?

Cameron Tidball

Yes. Definitely. Obviously, pandemics and price wars are not new to us. However, combined together, that is new territory for all of us in our careers. There's no doubt this price war between Russia and Saudi is impacting things. We continue to be in touch with our customers, but we know there will be changes. You've probably read some of the outspoken CEOs of E&Ps, and some of the things that they're trying to do to reassure shareholders. But as Brent said, it's not pretty.

That being said, we still get the calls. Our sales people are being asked the questions, "Will you have product?" And because of our inventory strategy, because of decisions we made in the past to invest in that, we believe we'll be able to handle customer needs and demands. But it's not a wonderful thing right now, but we'll have to see how it plays out, Rob.

Robert Brown

Okay. I appreciate the color there. And then in terms of the 3100, in particular, it has a little bit of a different customer base. How is that project pipeline going down? How much was that impacted by oil and oil prices?

Brenton Hatch

Cameron, again, this is—might be your show today, the way it looks. If you don't mind, do you want to...

Cameron Tidball

Sure. We feel that it is a little different clientele, however, there is some overlap. Thirty-One Hundred sales historically so far have been—a lot of it has been in our current business, upstream and midstream. But we try to move to these projects that are on, what we call, the downstream side of midstream, which is your larger appliances. So these customers, although they do pull from different plans and budgets, but we have heard of deferrals for sure. Some will continue to go forward. We've had some good projects already go through in the quarter. But we do expect some impact there as well.

Operator

Our next question comes from the line of John White with Roth Capital Partners. Please proceed with your question.

John White

Brent, you had some positive comments on supply chain and inventory, as you finished up your prepared remarks. Do you want to offer some additional color? Do you have exposure to Asian supply chain?

Brenton Hatch

Of course because we access some of our products out of China, we've been really rather concerned, of course, with present circumstances. But one of the positive things—I should have Jay Fugal speak to this and maybe I will in just a moment—we were wise enough in that department to make some decisions, which got products on the water prior to any of this happening. And it looks like we will have plenty of product, plenty of inventory because of those decisions that we made to move a little faster than some of these conditions have moved. So we're quite optimistic about how we're going to be able to handle things.

I appreciated Cam mentioning this; that because of the tradition of Profire always being able to have inventory when it is needed by our customers, there are—we have many customers that are still planning in spite of conditions to use our products and use them fairly aggressively. And that really sets us apart from some of our competitors.

But Jay, do you want to speak to that other issue of product availability and inventory?

Jay Fugal

Yes. Thanks, Brent. As we've really put our strategy towards having product available, we stayed very close in touch, bi-weekly, with our suppliers out of China. And we've been able to work with some people there on not just what we had in the pipeline, but how we pulled some of that forward. Brent is absolutely right, and Cam's right: the strategy and the team that's put all their effort behind that, we were able to get some of that product received in North America here prior to a lot of the troubles that they've been having over there.

However, I would like to offer, we do continue to work with them. Like I said, even bi-weekly, really helping understand better how this is going to impact us. And we've got contingency plans in place to help with that.

Ryan Oviatt

And Jay, maybe if I can just add to that, from a range of our products, we're talking about direct exposure just in relation to the MEP product or the Millstream product that we acquired midway through the year, this year. And that's been a great addition to our product offerings. We continue to grow that portion of our business and the amount of that that we're selling.

But that doesn't cover our traditional BMS systems and our supply chain for that, those are all sourced either in Canada or in the U.S. And many of our other third-party components, our direct sourcing is through the U.S. and Canada. The thing we don't fully know is how many of those suppliers are going to be hit and impacted by the China supply chain. So there's likely other indirect supply challenges there.

As we also said in our prepared remarks, we tend to carry a large amount of inventory on the books, and we have a large number of systems and so forth. So we're working with those suppliers as well and staying in close contact with them. And so far, are not being told of any significant issues or challenges or delays. Obviously, this is an evolving situation, and we'll have to evolve as it evolves.

John White

Well, that's a smart move, decisive move and astute management. So congratulations.

Brenton Hatch

Thank you.

John White

And a follow-up, if I may. Cap ex for 2019 was significantly higher year-over-year and during these calls in 2019, you did a good job of telegraphing that to us. Do you want to offer any telegraphs on cap ex for 2020 at this time? And I know you're not going to be real specific; I understand that.

Ryan Oviatt

Thank you. John, just to clarify, you're talking about Profire's cap ex, not industry E&P cap ex?

John White

Oh, yes. We're not even going to talk about E&P cap ex.

Ryan Oviatt

Perfect. Because I don't even want to talk about that.

Brenton Hatch

Nothing to talk about.

Ryan Oviatt

But yes, great question. The cap ex that we invested in 2019 was primarily all related to our new building up in Canada. That has been virtually completed. We're actually in the new building. Cam and Jay are actually joining this call from that new building. We moved in, I believe, all of our staff up there over the last weekend and on Monday, so we're there. The building is up and running, functional. Obviously, with any new construction and project, there's some trailing, finishing touches or touch up, that type of thing that is still ongoing. But pretty much for the rest of the year, it's minimal. So there will be a little bit of carryover cost associated with that. At this point—

Brenton Hatch

Minimal.

Ryan Oviatt

Minimal. I mean, it'll probably be maybe \$500,000 or something that we'll see this year as just finishing that up. And again, a lot of that's already been incurred in January and February. We don't have any plans for major cap ex beyond that. We do have a truck fleet that we rotate as those items are needed. But in this current environment, we're looking at, can we get a longer life out of our vehicles and maybe deferring some of those investments. So there will be some cap ex this year, but it will be a fraction of what we saw for 2019.

John White

Well, quite a bit of detail considering Management's customary comments. Seriously, I appreciate that color and I appreciate that detail.

Ryan Oviatt

Thanks, John.

Brenton Hatch

Thank you, John. Appreciate it.

Operator

Thank you. Ladies and gentlemen as a reminder if you would like to join the question queue please press star, one on your telephone keypad.

Our next question comes from Samir Patel with Askeladden Capital. Please proceed with your question.

Samir Patel

One comment and one question. And the comment, to echo the previous caller, is just wanted to congratulate you guys on the way you run your business. I think it's times like these that really speak to the value of having a strong balance sheet, a focus on cash flow. And as a shareholder, it's nice to know that no matter what happens, you guys are going to be around to invest and thrive coming out of a downturn. So that's the comment.

The question is regarding your international growth ambitions. You spoke a little bit about it in the prepared remarks, but I was hoping I could get a little more color. It seems like that's one of the interesting areas right now. Because obviously, industry demand is down. But on the other hand, you're kind of growing from a base of zero or near zero with some of those international distributors. A couple of quarters ago, I think, you had talked about some markets being somewhat more competitive than others with regards to the existing technology from other players that those markets are using. Maybe if you could just speak to early learnings and kind of where you see traction and kind of what your expectations are for that piece of the business in 2020?

Brenton Hatch

We have Cameron.

Cameron Tidball

You bet. Really, we spent a lot of 2019 trying to find the right types of partners. You don't want to just throw it into a big machine, where you're another product on a line card that you hope gets brought up. We look to finding companies similar to ours that were in instrumentation, hopefully in combustion, in markets that we had investigated through research to find out, obviously, is their production strategy similar to that of North America where heat is required. Through this journey that—we didn't deviate it through 2019. We kept on it. We've brought on six partners or are in process of bringing on those six partners. And for the most part, we have the globe covered in terms of the geography where our equipment, our products could be used. Now comes the fun part, and that is working with these distributors, getting in with their customers, determining their budgets, determining what competitive products exist; that's kind of our steps right now. In fact, we have a crew that's in South America right now, meeting with customers and training, etc.

Our expectations are, we believe that we'll continue to learn more of where our product is. I took a call not even a month ago, Saudi Aramco loves Profire apparently. However, technically, our product isn't

approved to be used with Saudi Aramco. So it's an interesting thing. Our products end up in these countries because domestic OEMs or fabricators use our products and ship them overseas. So it's going to be a great year of learning.

We do think that there will be some progress this year. We're to the point of—we're still planting seeds, but there should be some harvest this year. But again, how is this all going to be impacted by the markets, commodity prices, we'll have to see. But we're really excited about the progress that we're seeing there.

Operator

There are no further questions in queue. I'd like to hand the call back to Management for closing comments.

Brenton Hatch

Thanks, Melissa. Thanks, everybody, for joining us today on this call to discuss our fourth quarter and the full year, actually, of 2019. We'd like to thank all of you for your continued support. As always, we're available to answer any questions that you might have, discuss different matters that you might be interested in, feel free to contact us.

Thank you, each of you, and have a great day.

Operator

Thank you. Again, I would like to remind everyone that this call will be available for replay through March 26, 2020, starting later this evening via the link provided in yesterday's press release or in the Investor Relations section of the Company's website. Thank you, ladies and gentlemen. This concludes today's call. You may now disconnect your lines.