Profire Energy, Inc.

First Quarter 2017 Earnings Conference Cal

May 11, 2017

CORPORATE PARTICIPANTS

Brenton Hatch, *President and Chief Executive Officer*

Ryan Oviatt, *Chief Financial Officer*

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CONFERENCE CALL PARTICIPANTS

Rob Brown, *Lake Street Capital Markets, LLC*

Joseph Reagor, *ROTH Capital Partners*

George Gaspar, *Private Investor*

PRESENTATION

Operator:

Good afternoon, everyone, and thank you for participating in today's conference call to discuss Profire Energy's Fiscal First Quarter ended March 31, 2017. Joining us today is the President and CEO of Profire Energy, Brenton Hatch, and CFO, Ryan Oviatt.

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 ability to allocate resources to take advantage of opportunities; the Company's R&D Department being able to develop products in addition to its 3100 products; that future products will add significant value to the Company; that the Company will be able to timely deliver products with increased sales; the Company's newly established sale vertical support the 3100 products will be able to meet gross projections; the Company focusing on reducing expenses; improving operational processes and making necessary investments; the Company's belief that low oil prices and lack of drilling and well completion impact the Company's ability to capture revenue; the Company's ability to execute on its capital allocation plan; the Company's ability to effectively manage costs; the Company's intent to execute its share repurchase program; and the Company's ability to employ capital to generate meaningful returns in future periods.

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 involves 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 risks, and factors identified in the Company's periodic reports filed with the Securities and Exchange Commission.

All forward-looking statements are 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 it will be available for replay through May 18, 2017, starting later this evening. It will be accessible via the link provided in today's press release, as well as on 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, Misters Hatch and Oviatt will be joined by Profire Energy's VP of Sales, Cameron Tidball.

Now, I would like to turn the call over to the President and Chief Executive Officer of Profire Energy, Mr. Brenton Hatch.

Brenton Hatch:

Thank you very much. Good afternoon, everyone. Thanks for joining us today. We're excited to provide an update on our first fiscal quarter of 2017. Our first quarter exceeded our expectations as we were able to see an increase in the revenue and maintain our cost structure. As the oil and gas industry began to rebound, we were able to meet customer's demands. The industry continues to show signs of improvement and we will allocate resources to take advantage of opportunities as they arise.

Some of the quarterly highlights include the fact that with our increase in revenues, we were able to control costs and working capital to again generate positive cash flow, which Ryan will talk about later. During the industry downturn, we added many new customers, some of whom began purchasing significant quantities in the quarter. Throughout the quarter, we have seen growth in all basins in the U.S, but specifically we've had dramatic increase in activity in the Permian.

In the quarter ended September 30, 2016, we saw a 26% increase in quarter-over-quarter revenues. Then in the quarter ended December 31, 2016, revenues increased an additional 41%. As indicated in our previous earnings call, we had projected that our revenues would remain flat through the first two quarters of the fiscal year 2017. However, we accomplished a further 11% increase in this quarter. For the past three quarters now, we have been able to achieve double digit increases.

The strength of our balance sheet has been a key enabler of the strategic accomplishments of Profire. We remain debt free. We generated positive cash flow this quarter as we have on an annual basis for many years, including during the industry downturn. We have conducted a significant share buyback program and still had $21.7 million in cash and liquid investments at the quarter end.

We will continue to seek out opportunities that will drive long-term value for the Company and our shareholders, while generating meaningful returns on capital. We are investing in research and development to enhance the capabilities and applications of our 3100 product, our advanced combustion controller. We believe that it will drive significant value for the Company in the coming years. In an effort to remain a market leader and deliver reliable and innovative products to our customers, our R&D team is continually developing other products, in addition to the 3100 that we believe will add significant future value to Profire.

We are happy with the way our Company is able to handle the ebbs and flows of the industry and it's believed that we can continue to augment our success.

I will now turn the call over to Ryan Oviatt, our CFO, to discuss the financial results for the quarter. Ryan?

Ryan Oviatt:

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

In this quarter, we were able to see significant overall improvement when compared to the same quarter a year ago. Let's begin by looking at the income statement. In our first quarter of 2017, our total revenue increased to $7.8 million, a 72% increase over the same quarter a year ago. This increase is at least partially attributable to the industry recovery in the past 12 months and increased cap ex spending by oil and gas companies.

In looking at the industry as a whole, uncertainty continues around OPEC production decisions and the U.S. Shell projection. The rig count in the U.S. has continued to increase during 2017, while the rig count in Canada has declined over the last couple of months, primarily due to the annual spring breakup cycle. The numbers of drills at uncompleted wells has increased recently, which some speculate is due to the lack of required completion equipment. Recent studies have shown that the break-even price for U.S. Shell producers has dropped on average to $35 per barrel. Overall, we believe these industry trends will have a positive impact for Profire and our customers in the coming quarters.

Now moving on. Our gross profit increased to $4.4 million or 56% of total revenue, as compared to $2.3 million or 51% of total revenue in the same quarter last year. Gross profit remains strong, but varied a little each quarter due to the sales product mix for the period.

Total operating expenses increased slightly to $3.3 million from $3 million in the same year-ago quarter. This increase in operating expenses is primarily due to a one-time expense in connection with the retirement of our former CTO. In the absence of this nonrecurring charge, operating expenses would have been slightly lower than the year-ago quarter and consistent with our final quarter of last year. Operating expenses for general and administrative increased 10%, R&D increased 29% and depreciation increased 5%, as compared to the same quarter a year ago.

Our cost cutting initiatives combined with ongoing cost management make it possible for us to respond to market demand while maintaining profit margin. Profire remains committed to product development and technology, therefore we continue to invest heavily in research and development.

Total other income during the period was roughly $28,000, the majority of which was attributable to interest income.

Our net income was $600,000 or $0.01 per diluted share, compared to a loss of $765,000 or a loss of $0.01 per diluted share in the same year-ago quarter.

As noted earlier, during the quarter we recognized the one-time expense related to the retirement package offered to our former CTO. Without this nonrecurring expense, we would have recognized net income of approximately of $885,000 or $0.02 per diluted share.

Cash and liquid investments totaled $21.7 million as compared to $20 million at the end of the previous quarter and $21.3 million a year ago. In the past year, we have been actively repurchasing our own stock as part of our previously communicated capital allocation strategy. Under this program, as of May 5, 2017, we have purchased 3.4 million shares of Profire stock for $4.3 million. Despite the challenging industry circumstances of the past year, we have been able to fund these stock purchases through operating cash flows. Generating positive cash flows will continue to be a key area of focus for the Company.

Working capital management also remains a strong focus for the Company. Inventory levels have increased slightly from the previous quarter. As a result of our vendors increase lead times, we have strategically purchased inventory to ensure that we can meet our sales projection in the coming quarters.

Despite the fact we increased sales by double digits in each of the past three quarters, our accounts receivable has decrease in the current period. Through the continued collection efforts, we have reduced AR over 90 days old from 32% a year ago to only 13% now.

We will continue to strategically allocate capital according to the plan we have previously communicated. We will focus on the preservation of cash, new product development, potential acquisition of adjacent technology, continuing our stock repurchase program and seeking out other value creation opportunities. These actions will allow us to continue to serve our customers while bringing new products to market quickly and efficiently and increase value for shareholders.

The cost in Company structures we now have our fairly scaleable, with a substantial increase in revenues of 72% over the prior year and 11% over the prior quarter, our operating cost structure has remained relatively flat when you exclude one-time items.

Through strategic inventory purchasing and the efforts of experienced sales and operations teams, we expect to continue to respond in a timely way to increase sales as the industry recovery strengthens. We remain committed to managing our costs, but we will not forego investments that have significant long-term benefits for the Company as we plan for the future.

With that, thanks and I will send it back to you Brent.

Brenton Hatch:

Thanks, Ryan. As Ryan has highlighted, we continue to generate positive cash flows from operations and continue our investment in higher interest income opportunities. During this quarter, we continued our stock repurchase program. Throughout the quarter, we hired needed personnel in our operations department, as well as in R&D to allow us to fulfill orders and to fully explore opportunities. Our increased investment in R&D is largely focused on supporting our 3100 product. We believe that the 3100 controller sales will increase in the coming quarters. The 3100 allows us to work in much larger projects than we were previously able.

In order to support the growth and demand for the 3100, we recently created a new sales and support vertical. These larger 3100 projects include engineering, design, a longer sales process and more complex installations. With this specifically dedicated workforce, we feel we will be able to effectively execute our growth projections for the 3100.

Despite the recent dip in commodity prices, many analysts believe prices will average from the low to mid 50's range throughout the end of the year. We remain cautiously optimistic that this is the case and that this will continue to drive an increase in our sales. We remain a market leader in the burner management industry and are positioning ourselves for continued growth. Our cash position allows us to remain flexible and make strategic investments, both internally and externally. We are dedicated to serving our current customer base and our focused mainly on providing solutions within the oil and gas industry. We are looking into the possibility of expanding into other industries with the ongoing development of the 3100.

Thank you for investing and showing interest in Profire. We remain passionate about our products and our customers and plan to see Profire return to and exceed our historic revenue levels as the market recovers.

Now with that, I will open this call up to questions. Operator, would you 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 key pad. 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. One moment please while will poll for questions.

Thank you. Our first question is from the line of Rob Brown with Lake Street Capital. Please proceed with you question.

Brenton Hatch:

Morning, Rob.

Ryan Oviatt:

Morning Rob.

Rob Brown:

Good morning. Congratulations, on a nice quarter.

Brenton Hatch:

Thank you sir.

Rob Brown:

On account of the industry demand trends and recovery, how has that continued on more recently with kind of the more with kind of volatility commodity prices, and in general, sort of what is your view on any pent up demand out there?

Ryan Oviatt:

We have seen of course the prices bounce up and down with oil and we have not—and we have monitored this pretty carefully. We have not seen any significant difference in the interest of our customers in purchasing. Orders are still coming in as we would expect and hope. Capital budget seems to be there, as I had indicated in my previous comments. Most of the shale producers are on average making money or breaking even at the $35 level and some even less than that, and so it balances in these high 40's and low 50's. We haven't seen a significant change at all in possibilities for ourselves.

Rob Brown:

Okay, great, and then on the 3100 business, that's developing nicely, could you give us a sense of how much that is today of the business and maybe a longer term view of what the 3100 business can become as it plays out?

Ryan Oviatt:

You bet. We of course have been watching this with great interest ourselves. Cam, you have been actively involved in the sixty or so projects I guess we've been involved in this past year. Do you want to address this?

Cameron Tidball:

Yes, for sure. As you alluded to in your comments, in the script there, these projects are bigger, they take longer, the sales cycle is longer. You mentioned as well and for everyone on the call, we have recently created a new vertical, a sales vertical which will be exclusively focused on 3100 business development. So far that—we've seen obviously some great interest, we know that the product is desired. That sale cycle, of course though will be longer. We are already working on projects into 2018, and so we will see some ebbs and flows, up and down quarters with the 3100, but as we continue to build a backlog of projects, which is our desire, we are going to be able to realize a lot more with respect to the 3100. So, still revenues our up and down per quarter, but interest continues to go up and increase as we get out to more and more customers that can use this product on some projects we just quite frankly could never do before.

Brenton Hatch:

Cam, I might add to that, the sales vertical that we have created includes more than just sales people and you might speak to that as well, some of these other—because these are engineered products, some of these other people are required in this.

Cameron Tidball:

Yes. We have brought in prior to this as well, a project management arm, R&D support, as well as commissioning expert. The project management arm was brought from external, from a highly reputable company. The sales arm was grown from within, from someone that we strategically hired two years ago, knowing that this project was in the mix, and then from a perspective of technical documentation—and all those things are required and we can charge for on these projects, we've put those in place. So, we are going to be able to execute on these project much quicker than our competitors, at least that's our belief, and show that nimbleness that Profire has always shown in our niche market.

Rob Brown:

Okay, great. Thanks for the overview. I'll turn it over.

Brenton Hatch:

Thanks Rob.

Cameron Tidball.

Thanks Rob.

Rob Brown:

Thank you.

Operator:

As a reminder to ask a question today, you may press star, one. The next question comes from the line of Joseph Reagor with ROTH Capital. Please proceed with your questions.

Joseph Reagor:

Good morning guys.

Brenton Hatch:

Morning Joe.

Joseph Reagor:

Thanks for taking the questions. Couple of things. I guess first, you didn't mention much about the chemical management system arm of the sales. You know, can you give kind of—I mean historically you have been giving a rough estimate on percentage of sales of what that represented. Can you guys provide that again?

Brenton Hatch:

Sure. Ryan do you want to address that one?

Ryan Oviatt:

Yes, so certainly that one again has been a very small contributor to sales at this point. In Q1, the numbers were down from what we've seen in the past, but Cam can speak probably a little bit more on some of the opportunities that we are still working on there. Overall, it represented less than 2% of total revenue in Q1. Cam do you want to comment about the other opportunities on the CMS side?

Cameron Tidball:

Yes, for sure. Both Ryan and Brent's comments are exact, in that we haven't realized the revenue from direct CMS, however again it is one of the easiest meetings to get and what it's turned into, especially in the midstream space is allowing us to get on to sites where, oh look at that piece of equipment that could use a 3100 or a BMS upgrade. So, it has spurred a lot of other business for Profire, which is hard to quantify, but it is definitely noticeable from our end and our sales people. So, they still continue to get those meetings. We have some significant opportunities that we hope can bear fruit. We are still working with some major exploration companies on some pilot units and trialing things out. We have had some success there. Again, it's one of those things, in the chemical world, they've got their budgets in place and unless a company is incenting people to save money there, they are not looking in the spot. So, we know we have case studies, we have done well with people, so it's just finding those right customers. We are very excited and hope to have something in this quarter with a couple of majors.

Joseph Reagor:

Okay. Then, you know, Q1 was above your expectations by a pretty good percentage basis, and Q2 rig count looks like it is up from Q1, average, 50 to 100 rigs already. Do you guys think Q2 is capable of reaching the same level of Q1, or are you guys, holding back on that a little because you were saying some of the drilled (phon) but uncompleted wells inventories are increasing?

Brenton Hatch:

That's a great question. We wish we had the capacity to really see what the future holds, but yes, our expectations are very—we're very optimistic. We feel like there is a lot of interest out there in the products we have and this new 3100 project, as Cam said, some of the work that we are doing now won't necessarily be seen in this coming quarter, but in subsequent quarters. But, we have no reason to believe that the momentum that we have achieved can't continue with a lot of hard work. Our sales people are really out there and really doing the job. We did a lot of ground work during the downturn actually, and as I had mentioned earlier in my comments, even from some of the new customers that we got during the downturn, we're seeing some significant purchases. So, we have no reason to believe that we can't keep up this momentum, and if we keep our noses to the grindstone, as it were.

Joseph Reagor:

Okay, and then one final one, just a clarification. Ryan, you spoke on G&A costs. This quarter G&A was about 2.9, last quarter it was 2.5, historically it's more like 2.3 it seems on average. Should we be using that 2.5 or the 2.3 number going forward?

Ryan Oviatt:

We expect that overall, we have increased some costs slightly, so I think the 2.5 number specifically. Some of my comments were kind of the overall, general operating, including R&D and depreciation, but we've seen a little bit of an increase in costs overall with the additional staffing that we've talked about, but probably use the 2.5 number going forward.

Joseph Reagor:

Okay, great. I'll turn it over.

Brenton Hatch:

Thanks Joe.

Ryan Oviatt:

Thanks Joe.

Joseph Reagor:

Thank you.

Operator:

If you would like to ask question today, please press star, one from your telephone keypad. The next question is coming from the line of George Gaspar, Private Investor. Please proceed with your question.

George Gaspar:

Yes, thank you kindly. Don't know if you can identify this for us, but can you give us some range about the individual installation sales that you are making, the value of them, and how does this 3100 unit compare with what you've done generally? That's one part of the question. The other is can you break out your sales volume by oil region in the United States by area, if possible?

Brenton Hatch:

You bet. Cameron, do you want to talk about those sales issues?

Cameron Tidball:

Yes, the first question, can you repeat that again George? I got the second one, I know to break out by shale region, but the first question, can you come again on that?

George Gaspar:

The value per unit installed basis, what's the value of your individual installs that you've been making, and then how does this 3100 unit that you are talking about is going to be valued comparatively speaking?

Cameron Tidball:

Yes, that's a great question. I can answer it with a Profire standard answer, it depends, but I will give you a little more color than that.

George Gaspar:

Okay.

Cameron Tidball:

On our legacy product business, so that's 2100 business on upstream production and processing equipment, you can be anywhere from a box sale with $2,500 all the way up to a $10,000 pre-assembled fuel train solution. So, a fair number that we use often is in between that $4,000 and $5,000 on average for legacy product and it all depends on what part of it, because we as a Company don't install everything that we put in the field.

Now, on the 3100 side, you can range anywhere from a $10,000 sale to a high six figures, $300,000. We'll know we'll see projects higher than that, we know we will have projects in the $30,000, so it's a very vast range, and out of the last five quarters where we've been tracking 3100 projects, we're in the kind of 75 80, up to between there and 100 project. We've had that range anywhere from 6,000 to in the high two's. So, it all depends on what we are going to do. Obviously, those six figure projects, they are longer lead time, into up to a year, maybe even two years. We are already—we are going to have to start putting it out there. We are booking into 2018, which is a nice thing, but that's just a marketing strategy to get people incented, but yes, we have to rely on turnarounds for these projects which are sometimes scheduled one, two, three years out. So, I don't know if that—doesn't really give you something you can model on the 3100 side because it is so vast, but it has been very vast so far.

George Gaspar:

Mm hmm. Then on the area's regional ...

Cameron Tidball:

Oh right.

George Gaspar:

Can you give us some color on that, where the breakout of your sales are coming from?

Cameron Tidball:

Yes. So, we've focused on obviously on about eight different shale regions in the United States. Our territories will cover everything from the (inaudible) in the Permian, Colorado, Wyoming, the Marcellus Utica, etc. For the most part, our strongest in this last quarter, our strongest revenue, I guess contributors would be Pennsylvania, The Scoop, The Stack in Oklahoma, the Permian Basin, those are all very close in contributions, they're all raw revenue. Then we have continued to do well in Colorado, Ohio and the Balkans. Overall, you could say the majority is coming from the first four that I mentioned, Permian, Pennsylvania and Oklahoma, but we are seeing great grounds in all of those areas. We have increased in all of them.

George Gaspar:

If I could ask this on a technical side, in terms of this seemingly much improving trend in the Permian Basin, in terms of the output and the combination of output between oil and gas liquids, do you find an opportunity expanding for you where you are related to pipe gas liquid ratios?

Cameron Tidball:

Well, Profire gets a taste of gas production and oil production. Obviously we like liquids because there's for the most part in the Permian Basin a higher ratio of burners and heaters to oil than there is heaters with gas, so we prefer that. However, Profire is getting a great taste on a lot of the new drilling activity in the Permian Basin, so as long as they keep using heaters, as long as wells are producing and they are completing them, we've got a great customer base. We should be able to reap reward.

George Gaspar:

Right. Okay, just a closing comment from my perspective. I'm relatively new at following your Company, but I have followed it for a few months here. It would be very interesting to see what is going to happen here. If I look at the historical perspective on the price of your security outstanding, relative to where it is now and the progress that you are making in innovations, it would seem awfully attractive for investors, and I'm wondering are you planning on making or getting out and making more presentations to investment conferences?

Brenton Hatch:

Well indeed, that's another great point that you make there. We are in fact, to answer your question, out there to conferences, doing non deal (phon) roadshows and such as much as we possibly can and still keep operations going. We also have a number of calls weekly with various brokers and investors where we talk to large groups, and so we are actively doing that, but it does seem to make a difference. We find that when we do get out in front of the public, when we can, at these conferences, we do see a surge in activity following those things, and so because of that we are going to make a continued effort to be very active that way.

George Gaspar:

Okay. Well, thank you kindly.

Brenton Hatch:

George, thank you for calling in.

Cameron Tidball:

Thanks George.

Operator:

At this time, this concludes our question-and-answer session. I would now like to turn the call back over to Mr. Hatch. Mr. Hatch, please proceed.

Brenton Hatch:

Thank you Rob. Thanks everyone for joining us today on our call to discuss the results of this first fiscal quarter. We would like to thank our customers, we appreciate them very much. Our employees, of course add a great deal to our success, and of course our shareholders for their continued support and encouragement. Please know that we are always available for any of you to discuss any questions and concerns that you may have. Please contact us at numbers that are available on our website. Thank you everyone. Have a great day.

Operator:

Thank you. Again, I would like to remind everyone that this call will be available for replay through May 18, 2017 starting later this evening via the link provided in today's press release and in the Investor's section of the Company's website. Thank you ladies and gentlemen for joining us today for our presentation. You may now disconnect.