## Appulse Corporation

## Management's Discussion and Analysis April 4, 2023

## For the three months and year ended December 31, 2022

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The following Management's Discussion and Analysis ("MD&A") reflects management's assessment of the consolidated financial and operating results of Appulse Corporation ("Appulse" or the "Corporation") for the year ended December 31, 2022. This MD&A should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2022 and 2021. The consolidated financial statements were prepared in accordance with International Financial Reporting Standards ("IFRS"). Unless otherwise noted, all financial information is expressed in Canadian dollars. Additional information on the Corporation and its financial and operating results can be accessed through the SEDAR website at www.sedar.com or the Corporation's website at www.appulsecorp.net. The information contained in this MD&A is given as of April 4, 2023, unless otherwise stated.

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**Forward looking statements**

Certain statements and other information included in this document constitute forward-looking information or forward-looking statements (collectively, "forward-looking statements") under applicable securities laws (such statements are often accompanied by words such as "anticipate", "forecast", "expect", "believe", "may", "will", "should", "estimate", "intend" or other similar words). All statements in this document, other than those relating to historical information or current conditions, are forward-looking statements, including, but not limited to, expectations related to: the continuing development of food and beverage markets; a continuing market for refurbished centrifuge machines; a continuing demand for centrifuge service and replacement parts; the continued access to markets in Ontario, Quebec and the west coast of the United States; and the impact of international political unrest.

All the forward-looking statements are qualified by assumptions that are stated or inherent in such forward-looking statements, including the assumptions referred to below and elsewhere in this document. Although the Corporation believes that these assumptions are reasonable, the list is not exhaustive of the factors that may affect any of the forward-looking statements and the reader should not place an undue reliance on these assumptions and such forward-looking statements. The additional key assumptions that have been made include, among other things, with regard to all of the forward-looking statements: assumptions that future business, regulatory and industry conditions will be within the parameters expected by the Corporation, including with respect to prices, margins, demand, supply, product availability, supplier agreements, availability and cost of labor and interest, exchange, and effective tax rates; assumptions with respect to the adequacy of our cash generated from operations and our ability to access our credit facilities for additional sources of financing.

Additional events or circumstances that could cause actual results to differ materially from those in all of the forward-looking statements include, but are not limited to: general economic, market and business conditions in Canada and the United States; the supply and demand and price levels for our products; governmental and regulatory requirements and actions by governmental authorities, including changes in government policy (including tariffs and trade restrictions), changes in environmental, tax and other laws or regulations and the interpretation thereof; political risks; the occurrence of a major environmental, or safety incident; innovation and security risks related to our systems; risks related to reputational loss; the ability to attract, engage and retain skilled employees; and other risk facts detailed from time to time in the Corporation's reports filed with the Canadian securities regulators.

Due to such risks and uncertainties, actual results achieved during any forecast period may vary significantly from information provided in this document. There is no representation by the Corporation that actual results achieved during the forecast period will be the same in whole or in part as forecast.

The Corporation disclaims any intention or obligation to update or revise any forward-looking statements in this document as a result of new information or future events, except as may be required under applicable Canadian securities laws.

**Non-IFRS measures**

Certain supplementary measures in this MD&A do not have standardized meanings as prescribed under IFRS and, therefore, are considered non-IFRS measures. These measures are described and presented to provide information regarding the Corporation's financial results, liquidity, and its ability to generate funds to finance its operations. The measures are identified and presented, where appropriate, together with explanations of differences from the equivalent IFRS measures. However, they should not be used as an alternative to IFRS measures because they may not be consistent with calculations of other companies. These non-IFRS measures, and certain operational definitions used by the Corporation, are further explained below.

i - Working capital

Working capital is defined as current assets less current liabilities as reflected in the consolidated statements of financial position. This measure does not have a standardized definition prescribed by IFRS and therefore may not be comparable to similar captioned terms presented by other users. Management considers working capital to be a key measure in assessing the overall liquidity of the Corporation and is calculated as follows:

| Year ended December 31, | **2022** | **2021** |
|---|---|---|
| Current assets | $ 9,022,369 | $ 8,694,192 |
| Current liabilities | 3,507,581 | 3,542,447 |
| Working capital | $ 5,514,788 | $ 5,141,745 |

ii - EBITDA

EBITDA refers to net income before finance expenses, tax expense, depreciation, and amortization. This measure does not have a standardized definition prescribed by IFRS and therefore may not be comparable to similar captioned terms presented by other users. Management believes that EBITDA is a key indicator of the results generated by the Corporation's core business activities. In addition, it eliminates non-recurring items and the impact of finance and tax structure variables that exist between entities. EBITDA is calculated as follows:

| Year ended December 31, | 2022 | 2021 |
|---|---|---|
| Net income | $ 237,542 | $ 742,284 |
| Finance expenses | 111,356 | 101,642 |
| Tax expense | 96,803 | - |
| Depreciation | 510,674 | 508,597 |
| EBITDA | $ 956,375 | $ 1,352,523 |

iii- Cash flow from operations before changes in non-cash working capital

Cash flow from operations before changes in non-cash working capital does not have a standardized definition prescribed by IFRS and therefore may not be comparable to similarly captioned terms presented by other users. Cash flow from operations before changes in non-cash working capital, as reflected on the consolidated statements of cash flows, should not be considered an alternative to, or more meaningful than, cash flow from operating activities, as determined in accordance with IFRS, as an indicator of the Corporation's performance. Management uses cash flow from operations before changes in non-cash working capital to analyse operating performance and considers it to be a key measure in demonstrating the Corporation's ability to generate the cash necessary to fund future capital investments and to repay debt. This measure is calculated as follows:

| Year ended December 31, | 2022 | 2021 |
|---|---|---|
| Net income | $ 237,542 | $ 742,284 |
| Adjusted for non-cash items | | |
| Depreciation | 510,674 | 508,597 |
| Stock-based compensation | 80,000 | - |
| Accretion (lease liability) | 39,896 | 55,484 |
| Deferred income tax expense | 42,502 | - |
| Cash flow from operations before changes in non-cash working capital | $ 910,614 | $ 1,306,365 |

**IFRS 16 - Leases**

As noted in the consolidated financial statements (Note 3(i)), pursuant to IFRS 16, the Corporation is required to recognize a right-of-use asset and an equal lease obligation at the start of any significant lease in an amount equal to the discounted present value of lease payments over the appropriate term of the lease. The primary application of IFRS 16 relates to leases on the Corporation's facilities in Calgary, Alberta and Waterloo, Ontario. After establishing the right-of-use asset and lease obligation, lease payments are allocated between interest expense and the reduction of the lease obligations. The right-of-use assets are amortized on a straight-line basis over the terms of the related leases. The application of IFRS 16 increased 2022 net income by $6,000, while reducing net income in 2021 by $ 18,000.

**Operating financial results summary**

The consolidated financial results for the years ended December 31, 2022 and 2021 include the activities of Appulse Corporation (“Appulse” or “the Corporation”), Centrifuges Unlimited Inc. (“Centrifuges”), Rolyn Oilfield Services Inc. (“Rolyn”), and Rolyn Oilfield Services (U.S.) Inc. (“Rolyn U.S.”).

Consolidated total revenues increased by 13% over the prior year to a level of $10,452,000 (2021 - $9,233,000). Components of revenue are reviewed in a following section. Revenues were derived primarily from customers involved in a wide variety of food and beverage production processes, supplemented by environmental, pharmaceutical, and oil and gas applications.

While revenues increased during 2022, income before taxes of $334,000 was substantially lower than the prior period level of $742,000. A reduction in the total gross margin accounted for the majority of this variance. Category margins are reviewed in a following section. Supply-chain challenges and inflationary pressures impacted margins, while the mix of revenue also contributed to the variance during 2022. Transportation logistics and cost increases also impacted margins. Increased labour costs comprised both enhanced compensation rates and timing inefficiencies, with delays due to supply chain issues. Covid-19 also had a continuing impact on efficiency, reflected through levels of operating and production costs. The 2021 comparative cost of sales figure includes the receipt of $248,000 in federal government assistance related to the Covid-related CEWS program. Improved supply-chain and transportation issues, and select inventory investments, will help to enhance profitability going forward. All billing rates related to customer service and product pricing have been increased to offset further inflationary impacts and higher employment costs.

Our key operating financial measurement, EBITDA, was $956,000 in 2022 (2021- $1,352,000) as reflected in the financial statements. Without the impact of IFRS 16, EBITDA would have been $614,000 (2021- $ 1,020,000).

2022 cash flow from operations before changes in non-cash working capital was $911,000 (2021-$1,306,000). Without the impact of IFRS 16, this figure would have been $569,000 for the 2022 year (2021- $ 973,000).

Pursuant to regulation, the following tables summarize specific annual financial information for the past three years, and quarterly information related to the eight most recently completed quarters:

**Selected consolidated annual information:** (thousands except per share figures)

| | | 2022 | 2021 | 2020 |
|---|---|---|---|---|
| Revenue | $ | 10,452 | 9,233 | 10,461 |
| Income attributed to equity shareholders | | 238 | 742 | 1,096 |
| Earnings per share - Basic and diluted | | .02 | .05 | .08 |
| Total assets | | 10,386 | 10,355 | 10,001 |
| Total non-current liabilities | $ | 271 | 564 | 889 |

**Summary of quarterly results:** (thousands except per share figures)

| | 4th Quarter of 2022 | 3rd Quarter of 2022 | 2nd Quarter of 2022 | 1st Quarter of 2022 | 4th Quarter of 2021 | 3rd Quarter of 2021 | 2nd Quarter of 2021 | 1st Quarter of 2021 |
|---|---|---|---|---|---|---|---|---|
| Revenue | $ 2,886 | 3,061 | 2,426 | 2,079 | 2,306 | 2,032 | 2,669 | 2,226 |
| Net income | 34 | 122 | 54 | 27 | 73 | 84 | 347 | 238 |
| Earnings per share Basic and diluted | $ .00 | .01 | .00 | .00 | .00 | .01 | .02 | .02 |

Note to consolidated financial summaries: No dividends have been declared on the Corporation's shares.

A review of period comparisons and management's outlook is provided in the following paragraphs.

## Fourth quarter results

Parts sales and service revenues during the last three months of 2022 continued at levels similar to the prior quarter. The average contribution margin on parts sales was also consistent with prior periods, while margins on service revenues were below expectations. As previously noted, service rates and part sale pricing have been adjusted to address the significant impact of inflation and supply-chain delays. Machine sales continued to be strong, with the last six months of 2022 accounting for 83% of total machine sale revenue. While total machine margins were lower in the final quarter, management anticipates a return to more traditional machine sale margins in 2023.

There were no significant changes to the operations, structure, or financial position of the Corporation during the three-month period.

## Financial statement component review

Primary components of the Corporation's year-end consolidated financial statements are reviewed in the following paragraphs.

## Revenue / Cost of sales

The sale of parts, both manufactured and those acquired from original equipment manufacturers ("OEM"s), represented 52% of total revenues during fiscal 2022, and will continue to be a dominant and reliable source of revenue for the Corporation. Revenues comprise both the direct sale of manufactured and OEM parts to customers and those complementing service revenues and machine sales. The Corporation supports a wide range of centrifuge types, models, and vintages, providing the diversity required to respond to the needs of many industries and customer applications. The effective sale of older refurbished machines depends on our ability to supply parts, sourced externally or manufactured through the Corporation's Design Machining division ("Design"). Total part sales were comparable to the prior year. Contribution margins increased in 2022 reflecting various sources of supply, and emphasizing the potential benefit of enhancing the sale of internally manufactured products. Design employs modern production equipment supported by an extensive library of parts drawings related to hundreds of models of centrifuge equipment. The recent purchase of additional machining equipment enhances our ability to effectively support machine service requirements. The capability to manufacture parts also serves to mitigate the impact of supply chain challenges.

A previous report noted a new representative relationship with an alternate international OEM supplier expected to further supplement parts and service revenues throughout Canada. While revenues were below expectations from this source in 2022, this supplier has an extensive customer base in Canada and we look forward to revenue growth in 2023. Centrifuges will continue to expand its manufacture of a wide range of aftermarket parts supporting a full spectrum of industrial centrifuge equipment, assisting to mitigate the impact of supply chain challenges.

Direct service revenue, not including related part sales, increased by over 20% compared to the previous year and represented 18% of total 2022 revenues. The contribution margin on total service revenue was lower during 2022. However, completing service on customer locations sites is no longer restricted by Covid 19 and service rates have been increased in response to the impact of inflation. Management expects margins and revenue to show further gains in 2023.

The sale of new and refurbished centrifuge machines represented 28% of total 2022 revenues. The ability to efficiently source, refurbish, and sell used centrifuge equipment is a key corporate strength, providing associated revenue from parts and continuing service in addition to the future sale of machines. While machine revenues were well above those of the prior year, difficulties encountered with a few transactions resulted in a reduction in the total contribution margin percentage. Margins are expected to return to traditional levels during 2023.

Rental revenues typically represent a very profitable source of revenue. The significant reduction in rental revenue further contributed to a lower total gross margin in 2022.

The total Cost of sales during the 2021 comparative period included the receipt of $248,000 from the federal government's CEWS program.

## Other Expenses

General and administrative expense increased by 12% compared to the previous year. Administration expenses for 2021 were reduced by the receipt of $116,000 from the federal government's CEWS program, which accounted for the major portion of the increase. The remaining 4% increase comprised growth in travel, occupancy, and compensation expenses.

Property and equipment owned by the Corporation is depreciated as outlined in note 3(d)(ii) to the accompanying financial statements. The 2022 depreciation expense related to these assets totalled $ 215,000 (2021 - $213,000). Depreciation also includes a charge related to the right-of-use asset pursuant to IFRS 16 in the amount of $296,000 (2021 - $296,000).

The 2022 stock-based compensation expense relates to the issuance of stock options on January 26, 2022. This charge has no cash impact or relevance to the Corporation's operations and is recorded with an offsetting credit to equity under the contributed surplus caption . There were no options issued during 2021.

The Corporation transacts in United States dollars for certain purchases and sales, and obtains centrifuge equipment from European suppliers, typically based in Euros. A primary component of the exchange loss recorded in 2022, relates to the change in the value of the Canadian dollar in relation to the Euro, while also reflecting exchange variations between the Canadian and United States dollars. The Corporation does not hedge foreign exchange transactions.

## Taxes

During the 2021 fiscal year, the Corporation utilized non-capital tax losses carried forward from a prior year to reduce taxes otherwise payable. The benefit of these losses had not previously been recognized in the accounts, resulting in a nil tax expense for the 2021 fiscal period. The tax losses carried forward have now been utilized resulting in current and deferred tax liabilities as at December 31, 2022.

Taxes are calculated individually for each of the Corporation's subsidiaries. The Corporation will continue to evaluate each subsidiary on an independent basis and will use a consistent philosophy in reflecting tax recoveries or expenses in the accounts.

## Inventory

The 2022 year-end inventory reflects a programmed increase in parts, carried in response to a series of external factors. In order to mitigate the impact of supply chain issues related to specific part categories, the Corporation took advantage of purchase opportunities as they became available. Anticipated inflationary trends were also considered early in the year where opportunities were identified to secure the supply of certain key parts. Securing the ability to service new models introduced to the market also resulted in a further inventory investment. With respect to internally manufactured parts, efficient production cycles typically result in increased stock, especially in the short-term. Raw stock for manufacturing was also enhanced in recognition of supply challenges and the anticipation of significantly higher input costs due to inflation.

A major segment of the Corporation's business relies on the ability to source, supply, service and provide parts for older centrifuge machines. Maintaining a significant inventory of purchased and manufactured parts and related equipment is critical to this business model. The Corporation's reputation and ability to support and service a vast range and age of centrifuge models requires an extensive supply of parts. Effective sales of refurbished machines also requires an efficient support structure featuring timely service and the provision of spare parts. While the ability to provide support for older machines provides a revenue source, it also provides a critical opportunity to engage a new or reactivated customer, who may require further work or equipment upgrades in the foreseeable future. Engaging those customers also provides an opportunity to offer alternatives involving economically viable refurbished equipment and service support. A strong and experienced service team, a supply of required parts, and a strong machining capability create a structure to support the Corporation's operating model.

The investment in machine inventory provides the ability to meet customer demands in a timely fashion. Refurbished equipment provides customers with cost effective alternatives while avoiding extensive backlogs encountered in the purchase of new equipment. Delivery periods for new equipment have again lengthened significantly compared to prior periods.

The Design Machining division continues to meet an increased demand for internally manufactured parts, providing a high-quality product at competitive prices. Design also provides the Corporation with the flexibility to react in a timely and effective fashion to customer service needs.

Centrifuge machines used for rental to customers are reflected under property and equipment, as disclosed in the notes to the consolidated financial statements. Machines are transferred to property and equipment when they are allocated to the rental fleet and intended primarily for future rental activities.

**Property and equipment**

Property and equipment additions during the year totalled $221,000, comprised primarily of investments in the Corporation's rental fleet, in addition to shop equipment at both the Calgary and Waterloo facilities. Rentals provide the opportunity for customers to test processes and potentially obtain production equipment without the significant capital investment inherent in the purchase of new equipment. At December 31, 2022, the total property and equipment cost of $4,005,000 is carried in the financial statements at a net book value of $887,000. Costs related to an extensive library of drawings and hundreds of operations and parts manuals, have consistently been expensed in the accounts and are not reflected as assets on the financial statements.

## Working capital and liquidity

Cash flow from operations before changes in non-cash working capital was $911,000 (2021 - $1,306,000). Maintaining a positive cash flow from operations will continue to be a principal operating guideline.

The Corporation's working capital position was $5,514,000 at the 2022 year-end compared to $5,142,000 at December 31, 2021. If raw materials, parts, and machine inventories were excluded from working capital, the Corporation would have a working capital deficiency of $1,079,000 (2021 - $899,000). The Corporation's obligations to its banker, ATB Financial, are included in current liabilities, as they are due on demand.

Lease obligations reflected on the consolidated financial statements at December 31, 2021, reflect the assumed lease obligation created under IFRS 16, offsetting the right-of-use asset shown under the Assets section. Further details related to IFRS 16 are discussed earlier in this report.

Details related to the Corporation's current and long-term obligations and capital structure are summarized in the consolidated financial statements accompanying this report. (see Notes 4(d), 4(f), 10, and 11 to the consolidated financial statements). We look forward to the continued financial support of ATB Financial.

## Share capital

14,242,304 common shares of the Corporation were outstanding at December 31, 2022. In January 2023, 242,000 common shares were issued pursuant to the exercise of options under the Corporation's stock option plan, resulting in outstanding share capital of 14,484,304 common shares as of the date of this report.

## Contractual obligations and contingencies

The Corporation has no contractual obligations or contingencies of significance other than those mentioned in the notes to the consolidated financial statements. Reference is made to the Economic outlook section of this report.

## Related party transactions

There were no significant related party transactions during the 2022 fiscal year. Details of related party transactions and outstanding balances are disclosed in Note 12 to the consolidated financial statements accompanying this report.

Related party transactions include the purchase and rental of equipment from a company controlled by a director of the Corporation, Mr. R.D. Richards. When Appulse purchased Centrifuges, not all of that company's equipment was purchased, but available to Appulse as required. This arrangement provided a source of supply for Appulse, without the necessity to fund the purchase of all equipment at the time of securing control of Centrifuges. The agreement also included the ability to rent certain centrifuge systems owned by the director to third parties in return for payment of a fixed percentage of the rental revenue received.

There are no significant ongoing contractual obligations or other commitments resulting from any related party transactions other than normal trade accounts payable, as disclosed in Note 12 to the consolidated financial statements.

**Off balance sheet arrangements**

The Corporation does not have any financial or contractual arrangements that would significantly impact the Corporation's financial position or operating results other than those reflected in the consolidated financial statements.

**Economic outlook**

Worldwide economic and political landscapes continue to create a degree of uncertainty for many businesses. The Corporation's diversity of product application and equipment coverage provides a firm base for operations. It is management's opinion that the company's major customer and primary supplier bases are also well-positioned and capable of continuing strong relationships with the Corporation. Our primary markets, including dairies, meat packing plants, protein processing plants, fruit processors, wineries, and breweries, are to an extent insulated from the impact of changing economic conditions and priorities.

Supply chain challenges and inflation are expected to continue impacting operations in 2023, but to a significantly lesser degree compared to the current year. As noted under Inventory, certain key purchases were made during the current year which will help to mitigate the impact of product delays and future cost increases due to inflation. In addition, the pricing of all products has been adjusted to offset the continuing inflationary trend. While 2023 started at a slower pace, both Calgary and Waterloo facilities are currently active and we have recently increased our level of technical service staff to meet customer demands. A strong list of confirmed centrifuge machine sales for 2023 delivery is supported by an encouraging list of further high-probability machine applications. A continued emphasis will be placed on developing the scope and sale of internally manufactured parts, providing customers with parts availability on a timely basis at attractive pricing.

Extended delivery times for delivery of new equipment are also expected to increase customer interest in refurbished centrifuge machines. We will continue to emphasize our refurbishing expertise offering our customers high-quality products at reduced costs, while mitigating the impact of long delivery periods experienced with OEM product alternatives.

New opportunities will supplement our primary food and beverage markets during 2023, including pharmaceutical processing and environmental applications. The current strength of the oil industry offers further opportunities, although competition in that sector will be strong.

Geographically, the Corporation enjoys a diversified customer base from coast to coast in Canada. Sales to customers in the United States represented 20% of total revenue in 2022. Supported by a weak Canadian dollar, the sale of all products to a wide user base in the United States continues to present a firm opportunity for growth while providing an economically attractive alternative for customers. Providing complimentary service support to United States customers would further enhance our presence in a large potential market place.

Capital expenditure plans during 2023 include the enhancement of machining production capabilities, and the continued development of the rental fleet.

Management will continue to seek other investment opportunities, including strategic alliances within the centrifuge industry.

## Additional information

Additional information relating to Appulse Corporation can be accessed on SEDAR @ www.sedar.com and via the Corporation's website at www.appulsecorp.net