

Acorn Energy

Q2 2018 Earnings Release/Investor Call

August 15, 2018 at 11:00 a.m. Eastern

CORPORATE PARTICIPANTS

Bill Jones - *IR*

Jan Loeb - *CEO*

Tracy Clifford - *CFO*

Walter Czarnecki - *CEO, OmniMetrix*

PRESENTATION

Operator

Good day, everyone. Thank you for holding. And welcome to Acorn Energy's Second Quarter 2018 Conference Call. All participants are in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your telephone keypad. To withdraw your question, please press star then two. Please note that this event is being recorded.

I would now like to turn the conference over to Bill Jones, Investor Relations. Please go ahead.

Bill Jones

Thank you and welcome, everyone, to Acorn Energy's second quarter conference call.

First as a reminder, many of the statements made in today's prepared remarks or in response to your questions may be forward-looking. These statements are subject to various risks and uncertainties. For example, the performance of OmniMetrix and Acorn in 2018 and future years is subject to factors such as risks associated with executing its operating strategy, maintaining high renewal rates, growing its customer base, changes in technology, changes in the competitive environment, financial and economic risks as well as having access to sufficient capital to support growth.

Such forward-looking statements are based on management's beliefs as well as assumptions made which are based upon information currently available to management, pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. There is no assurance that Acorn or OmniMetrix will be able to achieve their goals for growth in 2018 and future years.

The Company undertakes no obligation to disclose any revision to any forward-looking statements to reflect events or circumstances after the date made. A complete discussion of the risks and uncertainties that may affect the company is included in Risk Factors on Acorn's Form 10-K as filed with the Securities and Exchange Commission.

With that, I'll hand the call over to Jan Loeb. Jan?

Jan Loeb

Thank you, Bill, and thank you, all, for joining us today.

I have some brief prepared remarks, Tracy Clifford, our recently appointed CFO will go over some financial highlights, and Walter Czarnecki, CEO of OmniMetrix, will provide color and insight as to underlying business trends.

As an overview, we continued to demonstrate solid growth and strong gross margins in our remote monitoring business. We expect this strength to continue given increasing customer awareness of potential productivity increases and lower operating cost that can be realized through technologies such as remote monitoring and the Internet of Things in general.

Walter will touch on why we think we're still in the early stages and our strategy to be a leader in the space and we are at the forefront of such trends.

With the disposition of DSIT, we are 100% focused on growing our industrial remote monitoring and

control business. At the corporate level, we will continue to support future growth both organically as well as through M&A.

In recent months, we have looked at several candidates. Our goal is to find a complementary acquisition in the IoT space that could help move us towards certain goals such as reaching profitability more quickly, utilizing our substantial operating loss carryforwards, and increasing shareholder value. We are looking for attractively valued lines of business or complementary technologies with high growth, recurring revenue, and synergistic opportunities.

We also plan to change the name of the parent company from Acorn in 2018 in order to properly highlight and define our business going forward. This will likely involve a new corresponding ticker symbol for our stock as well. We hope to have more updates on these objectives later in the year.

For those who may be new to our company, our operating company, OmniMetrix, monitors, manages, and protects high-value industrial assets for customers through its proprietary, remote monitoring, and control technology. OmniMetrix delivers substantial productivity increases and cost reductions to customers versus the alternative to remote monitoring, which is regular physical inspections onsite.

The OmniMetrix business consists of hardware monitoring equipment sales for new installations as well as ongoing monitoring service fees. The monitoring side of the business offers a very attractive combination of visibility from recurring service revenues along with strong gross profit margins.

On prior calls, we provided some forward-looking metrics and goals which I'd like to review. For full-year 2018, we have guided towards \$6 million or approximately 20% growth in cash basis sales. Through June 30th, we have recorded \$2.6 million in cash basis sales versus \$2.25 million in the first half of 2017. Cash basis sales grew 19% in Q2 2018 over Q2 2017.

We feel, we are on budget for \$6 million for the full-year as the summer typically begins our busier season in both OmniMetrix segments, due to warmer weather at the start of the hurricane season. Due to this seasonality, as well as to normal growth, we typically expect a higher level of sales in the second half of the year, we are therefore maintaining our \$6 million cash basis sales guidance for the full-year.

We caution that our recorded revenue growth typically lagged behind cash basis sales due to accounting standards which spread revenue recognition over the life of the contract or expected life of the hardware, though we typically receive the cash up front. Accordingly, it's important that investors understand this relationship between reported revenue and our cash basis sales to better appreciate our business trends.

Today we are pleased to introduce Tracy Clifford to investors. Tracy has over 20 years of experience in accounting and finance including M&A of public companies. Her financial and analytical capabilities will be key to our continued transformation of the company as we seek to grow our IoT business. Ms. Clifford previously served as CFO, Principal Accounting Officer, Corporate Controller, and Secretary for a publically traded pharmaceutical company and a publically traded REIT. She was instrumental in completing several financings as well as a number of acquisitions and dispositions. Her complete bio is available on our website. I'm very confident in her capabilities not only for SEC reporting but also in implementing new systems and controls to support the growth of our company.

I'd like to thank our former CFO, Michael Barth, for his many years of outstanding service to both Acorn, and to our former Israeli subsidiary, DSIT. Given that our remaining business is domestic our new CFO is U.S. based.

Before I turn the call over to Tracy, I'd like to review a couple of other corporate events. We filed an 8-K

last week which detailed the results of our Annual Meeting. At the meeting by vote of shareholders, two new directors were elected to our board of directors. The new board members are Michael Osterer and Gary Mohr, both of whom are long time shareholders who are very familiar with the company's history as well as our current focus. They both also have significant experience and backgrounds that will not only enhance our board but will be a valuable resource to our management team. I look forward to working with Mr. Osterer and Mr. Mohr and expect that they will assist our team as we pursue continued growth, ultimately for the benefit of shareholders.

I'd like to thank our former board members including Chris Clouser, Mannie Jackson, and Ed Woolard for their commitment and dedicated service to Acorn over the years.

Now I'd like to turn the call over to our CFO, Tracy Clifford. Tracy?

Tracy Clifford

Thanks so much, Jan.

I'm excited to join the company at this point in its transition and expect that my financial background and experience, particularly with mergers and acquisitions, will be an asset to the team. I'm also seeking to implement upgraded financial assistance to provide for more automated procedures and facilitate the provision of more detailed metrics for future strategic planning as we allocate resources for growth.

With respect to revenue recognition, as Jan mentioned, the OmniMetrix business includes the sale of equipment and monitoring services. Monitoring fees, which are generally paid in advance, are initially recorded as deferred revenue upon receipt of payment from the customer and then amortized to revenue over the service period, typically 12 months. Similarly, sales and cost of sales associated with hardware are initially recorded to deferred revenue and deferred charges and then recognized over the estimated life of the unit.

Beginning January 1, 2018, based on an internal analysis, the company increased the amortization period from two years to three years for hardware. This longer estimated life estimate of hardware units will have the effect of slowing revenue recognition on new hardware sales and thereby increasing the difference between reported revenue and cash sales, which is why cash basis sales are a very important metric.

Now I'd like to move on to discuss our financial results. Acorn's second quarter revenue rose 18% versus second quarter 2017 to \$1.2 million. All of our revenues are derived from our OmniMetrix subsidiary. The revenue increase was driven by growth in our pipeline monitoring or Cathodic Protection business, which grew 51% over the second quarter of 2017 to \$349,000. While the Power Generation segment revenue grew 8% over second quarter 2017 to \$881,000.

Gross profit at OmniMetrix increased 24% to approximately \$700,000 in the second quarter of 2018 compared to the second quarter of 2017, reflecting an increase in gross margin to 60% in the second quarter of 2018 compared to 57% in the prior year period. This margin increase was principally due to the rollout of higher end next-generation monitoring products, as evidenced by gross margins on hardware increasing to 35% in the first half of 2018 versus 27% in the first half of 2017.

The gross margin on monitoring revenue remained strong at 83% in the first six months of 2018 versus 85% in the first six months of 2017 with a slight decline attributable to a change in the mix of product monitored.

OmniMetrix's operating costs are relatively flat in the second quarter of 2018 compared to the second

quarter of 2017 at approximately \$800,000.

With revenue and gross profit growing faster than operating expenses, OmniMetrix reported a significant reduction in its operating loss to \$78,000 in the second quarter of 2018 versus \$200,000 in the second quarter of 2017.

Acorn's consolidated operating loss increased \$37,000 to \$544,000 in the second quarter of 2018 from \$507,000 in the second quarter of 2017. The 2018 period included approximately \$170,000 in non-recurring expenses including bonuses related to the 2018 DSIT transaction. Excluding these one-time expenses, corporate SG&A expense decreased \$11,000 or approximately 4% versus the prior year period.

Acorn reported a second quarter 2018 net loss to shareholders of \$538,000 or \$0.02 per share compared to a net loss attributable to shareholders of \$491,000 or \$0.02 per share in the second quarter of 2017.

Turning to cash flow, for the first six months of 2018, net cash and cash equivalents increased by \$1.3 million. The company used \$1.9 million in operating activities primarily due to the repayment of \$1.3 million of accumulated unpaid operating expenses previously funded by loans from directors and through advances in previous periods by DSIT. Acorn generated \$5 million from investing activities on the sale of DSIT and used \$1.8 million in financing activities ~~primaily~~primarily related to the repayment of director loans and loans from DSIT.

As of June 30, 2018, Acorn had been consolidated cash and cash equivalents of \$1.8 million. OmniMetrix had approximately \$190,000 of accounts receivable financing outstanding under its credit facility with approximately \$130,000 unused credit available.

Now I'd like to turn the call over to Walter Czarnecki to provide some comments related to OmniMetrix. Walter?

Walter Czarnecki

Thank you, Tracy.

At OmniMetrix, we remain very excited about the growth prospects in both of our divisions, Power Generation and Cathodic Protection. At the macro level, the Internet of Things, or IoT, sector remains an emerging growth market. More companies are recognizing that they can derive value in the form of productivity increases and cost reductions by deploying an IoT strategy. With respect to backup generators, increased volatility in weather patterns, and increased awareness of the high vulnerability of critical assets across various industries, it's forcing organizations to reexamine the reliability of their backup power systems.

With respect to gas pipelines, both owners and utilities are becoming increasingly more aware of the operational vulnerability of their pipeline networks as well as the increased compliance requirements they now face. Our value proposition resonates with these organizations and its main tenets are one, increased reliability and failure avoidance; two, increased productivity; three, reduced operating expenses; and four, better compliance.

In 2018, so far we have added more than a dozen new key customers in the oil and gas, retail, aviation, maritime, and education sectors as well as other sectors.

For investors, we believe Omni's high margins and recurring revenue model are attractive. As a company, we remain highly committed to the core values of the highest quality of products and services,

consistently delivering an excellent customer experience, and leading with innovations in the markets where we operate.

Thank you again for joining us today and I'm happy to answer any questions now, as well as discuss further in separate conversations.

So now let's turn the call over to the operator and open the call for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, we ask that you please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster. And ladies and gentlemen, as a reminder, if you would like to ask a question, please press star then one at this time.

And today's first question comes from Robin Bansal of Bansi Holdings. Please go ahead.

Robin Bansal

Yes, this question is for Jan. Jan, are you still expecting to be cash flow breakeven within a year?

Jan Loeb

Yes.

Robin Bansal

And so how do you, how are you expecting to get there because from what it seems like, this quarter in terms of costs and SG&A was about the same as last quarter or last year?

Jan Loeb

Okay, firstly are you talking about OmniMetrix or you talking about Acorn Corporate?

Robin Bansal

Corporate Acorn.

Jan Loeb

Okay. So we have said previously for Acorn Corporate that we expect by the end of 2019 to be cash flow positive. So we said OmniMetrix will lead that in terms of being cash flow positive, followed by Acorn. So the way we get there is, the growth in OmniMetrix—keep in mind that OmniMetrix has a very high incremental profit margin, so if they continue to grow at the current pace of 20% a year with the incremental profit margin will throw up a significant amount of cash and we at the corporate level are focused on reducing costs, and so we believe towards the end of 2019 on an Acorn corporate level we will be cash flow positive and OmniMetrix will be within the year.

Robin Bansal

Okay, thanks.

Operator

And ladies and gentlemen, as a reminder, if you'd like to ask a question, please press star then one at this time. Today's next question comes from Jack Mayer, Private Investor. Please go ahead.

Jack Mayer

Good morning. Congratulations on a very nice quarter. Jan, a question for you, in your presentation what is LDmicro [ph] you put up a slide which is on your web site as well which talks about value considerations and in that slide you came up with a potential value range of \$0.53 to \$1.10. Anything changed from then to now in your view of that slide?

Jan Loeb

No. I think that slide remains a good arbiter of value. There was a acquisition of a private company recently in the space that would give backing to the multiples we used to come up to that value. So I would only say that we have one more data point out there that shows that I think that valuation is the correct valuation.

Jack Mayer

What multiple was that deal done at, if that's publically known?

Jan Loeb

I don't believe it's publically known.

Jack Mayer

Got it, okay. And then you said in some months ago that you were looking to make acquisitions as you've discussed today but that if you couldn't do that within a year from when you originally made that comment that you would look to go in the other direction and that is to try to market OmniMetrix. Where does that stand in your thinking today?

Jan Loeb

I think that that thinking remains in place. I think that we are looking for acquisitions, we're negotiating with a company as we speak, which doesn't mean we're going to make one, but we have a number of candidates that we've looked at and have had discussions with for companies that would be very synergistic with what we do, and so that is my current focus. If we can't do an acquisition, it makes no sense for a company such as ours to be public, a small company whether it be \$7 million or \$8 million at that point in time in terms of cash sales. So it makes sense and would be the best for our shareholders that we would sell OmniMetrix at that point in time but that is certainly not what our focus is and nor do I believe that that will occur because I do believe that there is some very good synergistic acquisitions out there that will help really increase our value both building mass to the company, increasing our profit margins, and helping us to utilize our NOLs.

Jack Mayer

Okay, great. Thanks very much.

Operator

And ladies and gentlemen, as a final reminder, if you'd like to ask a question, please press star then one at this time.

CONCLUSION**Operator**

Showing no further questions I would like to turn the conference back over to Jan Loeb for any closing remarks.

Jan Loeb

Thank you. Having improved our balance sheet, reduced overhead and refocused the company on the

attractive monitoring and IoT space, we are now well-positioned for our next phase. A lower cost structure, combined with gross margin strength and operating leverage, should allow top-line growth to translate to bottom-line performance, which ultimately is the driver of shareholder value.

I want to thank you all for your interest in Acorn. I believe Acorn represents an attractive platform for building shareholder value. I'm grateful to the support of our shareholders and pleased to speak with any investors who have specific questions about the Company and our plans. Please contact our Investor Relations team to set up a call with me or to answer any questions you may have. Thank you again for your time today. With that, operator, we can end today's call.

Operator

Thank you, sir. Today's conference has now concluded and we thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.