Acorn Energy, Inc.

Fourth Quarter and Full-Year 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Jan Loeb, *President and CEO, Acorn Energy*

Michael Barth, *Chief Financial Officer, Acorn Energy*

Walter Czarnecki, *President and CEO, OmniMetrix*

PRESENTATION

Operator

Good day, everyone. Thank you for holding, and welcome to the Acorn Energy's Fourth Quarter 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 0. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then 1 on your telephone keypad. To withdraw your question, please press star, then 2. Please note that this event is being recorded.

I would now like to hand the conference over to Michael Barth, CFO of Acorn Energy. Please go ahead, sir.

Michael Barth

Thank you, and welcome, everyone, to Acorn Energy's Fourth Quarter 2017 Conference Call. Joining me today are Jan Loeb, Acorn's President and CEO, and Walter Czarnecki, President and CEO of OmniMetrix. Following our remarks, we will open up the call to questions.

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 our operating strategy, maintaining our high renewal rate and growing our customer base, changes in technology in the competitive environment in which we operate, financial and economic risks, and having access to sufficient capital to support growth. Such forward-looking statements are based on management's beliefs as well as assumptions made, 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 also 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 which may affect us is included in the risk factors in our Form 10-K filed with the Securities and Exchange Commission.

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

Jan Loeb

Thank you, Michael, and thank you all for joining us today. I will begin by making some overview remarks. Michael will then review our fourth quarter and full-year 2017 results, and Walter Czarnecki will follow to update progress in our OmniMetrix business. We will then open the call to your questions.

During 2017, we continued to deliver strong revenue growth and margin improvement in our remote monitoring and control business, OmniMetrix. At Corporate, we continue to — working to cut costs and strengthen our financial position to support future growth, and subsequent to year-end, we sold our remaining equity interest in DSIT, which we had spent considerable time and energy toward throughout 2017. The sale of DSIT leaves Acorn Corporate debt free and with approximately $2 million in cash after all deal expenses are paid.

Also in 2017, we completed the deconsolidation of our former GridSense subsidiaries. This was the final step in the liquidation process and helped improve our balance sheet by removing substantial non-recourse GridSense liabilities from our financial statements.

With the disposition of both GridSense and DSIT behind us, we can focus our full attention to growing OmniMetrix, our industrial remote monitoring and control business, which I've always felt was the hidden jewel of this company. OmniMetrix manages and protects high-value industrial assets of its customers through its unique remote monitoring and control technology, which delivers substantial cost reductions to customers versus the alternative, which is regular onsite physical inspections. OmniMetrix's business consists of hardware monitoring equipment sales for new installations as well as ongoing monitoring service.

The monitoring side of the business offers a very attractive combination of the visibility from occurring service revenue, along with very strong gross profit margins and solid cash generation characteristics. In 2018, we will focus on supplementing the organic growth our OmniMetrix sales teams are generating by pursuing attractively valued technologies and lines of business in the monitoring or broader IoT space. We seek to identify similarly strong recurring revenue and synergistic business models with the potential to enhance shareholder value.

To provide some perspective on what we have accomplished over the past two years, I should point out that we have reduced corporate expense to $1.1 million for 2017, from $2 million in 2016 and $3.6 million in 2015. That's a 69 percent reduction over two years. Moreover, our OmniMetrix business reported $4.35 million in revenues in 2017 versus $3 million in 2015, or approximately 43 percent growth over the two-year period and 21 percent over 2016. Also going back to 2015, Acorn had provided $930,000 to OmniMetrix in financial support in 2015 versus the $300,000 that OmniMetrix received from us in 2017. We do not expect to need to provide funding to OmniMetrix this year or going forward for their continued growth. We'll continue to look for ways to reduce and contain costs in order to enhance cash flow at both the operating company and corporate levels in 2018.

We held a conference call after the DSIT sale, so I don't want to repeat everything that we discussed, but we did provide a few forward-looking metrics and goals that I'd like to review. On our last call, we said we expected over $5 million of cash-basis sales for OmniMetrix in 2017, and we actually did $5.1 million compared to $4.2 million in 2016, an increase of 22 percent. Looking forward, we said we expected approximately 20 percent growth in cash-basis sales, which would be over $6 million in 2018, and we still feel confident in this level of sales.

We caution that revenue growth typically lags behind cash-basis sales due to accounting standards for revenue recognition. Because of this, it's important that investors understand the difference between our reported revenue and our cash-basis sales to understand the trends in our business. Michael will touch a little more on the aspects of revenue recognition in his remarks.

And, with that overview, I will hand the call back to Michael to review our fourth quarter and full-year 2017 financials. Michael?

Michael Barth
Thank you, Jan. I'd like to provide some highlights and color to today's press release and Jan's remarks. One thing to keep in mind is in 2016, Acorn sold a portion of its interest in DSIT Solutions, to Rafael Advanced Defense Systems, and they are — and thereafter no longer consolidated the results of DSIT or reported its investment and proportionate share of income using the equity method. As such, Acorn's consolidated financial results for 2017 are not directly comparable to the prior year period.

With respect to revenue recognition, sales of OmniMetrix's monitoring systems have multiple elements which include the sale of equipment and of monitoring services. Monitoring fees, which are generally paid 12 months in advance, are initially recorded as deferred revenue upon receipt of payment from the customer and then amortized to revenue over the monitoring service period, which is generally one year. Sales and cost of sales associated with hardware are similarly initially recorded to deferred revenue and deferred charges. Revenue and related costs with respect to the sale of hardware are then amortized and recognized over the estimated life of the units, which has up until now been estimated to be two years. It is because of this that our reported revenue recognition and profitability lag behind our generation of cash and why we expect to be cash flow positive in OmniMetrix before we are profitable.

Looking at our results, Acorn's 2017 fourth quarter revenue rose 8 percent to $1.1 million as compared to fourth quarter 2016 revenue. Revenue in both periods was only from our OmniMetrix subsidiary. The increase in revenue was driven by growth in the pipeline-focused cathodic protection, or CP, business. Revenue for the full-year 2017 was $4.4 million compared to $8.7 million in the prior year period, which included $5.1 million of DSIT revenue. Excluding DSIT's 2016 revenue, Acorn's revenue grew 21 percent in 2017 versus full-year 2016.

For the full-year 2017, Acorn's loss before discontinued operations was $2 million versus income of $167,000 in the 2016 period. 2017's results included a $308,000 impairment of Acorn's investment in DSIT. The impairment was the result of the reduction in the carrying value of Acorn's investments to the February sales price. In Acorn's 2016 results — Acorn's 2016 results included a gain of $3 ½ million on the sale of a portion of our interest in DSIT.

Focusing on OmniMetrix, I'd like to add some color to the business line. For full-year 2017, CP revenue increased 46 percent over 2016, to approximately $1 million. And power generation, or PG, revenue increased 16 percent, to approximately $3.4 million. OmniMetrix supported a 29 percent increase in gross profits of $2.4 million in 2017, from $1.9 million in 2016. The increase was due to both higher revenue and gross margin on hardware revenue. Hardware margins increased primarily due to lower costs of PG monitors, which benefited from product redesign. Overall gross margin on hardware improved to 27 percent in 2017, from 18 percent in 2016, while gross margin on monitoring revenue remained strong at 84 percent in 2017. With higher revenue and gross profit, OmniMetrix reported a reduced operating loss of $783,000 versus $1.1 million in 2016.

Turning to cash flow, in 2017, net cash increased by $240,000 over December 2016. During the year, $679,000 was provided by investing activities, primarily from the release of escrow deposits; $1.2 million was provided from financing activities, primarily from director loans; and $1.7 million was used in operating activities, including $1.6 million used in continuing operations. Both Acorn's corporate activities and OmniMetrix reduced their cash used in operations during 2017. Acorn's corporate activities reduced its cash used from $1.6 million in 2016 to about $1.3 million in 2017, while OmniMetrix reduced its cash used in operations from about $.7 million in 2016 to under $400,000 in 2017.

As of December 31, 2017, Acorn had net working capital of $1.2 million, which included $481,000 of cash. The closing of the February 2018 DSIT transaction provided us with approximately $1.9 million in cash after paying transaction costs, withholding taxes, and the repayment of all director loans and associated accrued interest and the assignment of $1.6 million of the amount due to DSIT for the purchases. Acorn's corporate cash balance on March 16, 2018, was approximately $2.4 million, and Acorn has not corporate debt outstanding. On the same date, OmniMetrix had approximately $452,000 of accounts receivable financing outstanding under its credit facility, with about another $194,000 of remaining unused credit available.

Now I'd like to turn the call over to Walter for a few remarks regarding OmniMetrix.

Walter Czarnecki
Thank you, Michael. The adoption of Internet of Things, or IoT solutions for critical assets, continues to gain momentum as more organizations recognize that diagnostic and prognostic data improves system reliability and improves decision-making. Throughout the natural disasters that occurred in 2017 and the snowstorms in the Northeast this year, OmniMetrix continues to play a key role in making businesses, governments, and residences more reliable.

Following Hurricane Maria's devastation in Puerto Rico, we have since made multiple trips there alongside our partners, to ensure critical infrastructure facilities have power. These facilities, along with several businesses, are entrusting us to deliver vital information to keep their generators prepared to run and in many cases, running consistently while repair work on Puerto Rico's electricity grid continues. Some of you may have seen photographs we posted on our newsfeed on LinkedIn about the work we are doing in Puerto Rico. If you have not, I would encourage you to follow OmniMetrix on LinkedIn so you can receive regular updates on some of our key initiatives.

We are also closely following the recently passed legislation in Florida requiring certain facilities to obtain back-up generators. This measure, HB 7099, requires nursing homes across the state to have back-up generators as well as a 72-hour supply of fuel. This new law, combined with OmniMetrix's technology, can save lives in any unfortunate events if Florida is faced with another hurricane.

We remain excited about the increasing awareness of remote monitoring and control within the business, government, and residential communities, and we remain confident that OmniMetrix is well positioned to capture the opportunity of this growing market. As always, I am happy to discuss the business and market opportunity in greater detail on a one-on-one basis with anyone interested.

And, with that, Operator, let's 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 1 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 2. At this time, we will pause momentarily to assemble our roster. And, once again, ladies and gentlemen, that's star, then 1 if you have a question. Once more, we will pause while we assemble our roster.

Okay. It looks like our first question today comes from Michael Rindos of Dawson James. Please go ahead.

Michael Rindos
Hey, guys, thanks for taking my call. Can you hear me?

Jan Loeb
Yes.

Michael Rindos
Okay. Can you tell us how many units you have in service, monitoring units?

Jan Loeb
Walter?

Walter Czarnecki
Yes, we have in the tens of thousands of units, but we don't disclose specific data on that.

Michael Rindos
And the tens — okay. Can you tell me about the devices that are installed? Are they off-the-shelf units, or are they custom? And who installs the devices at the customer locations?

Walter Czarnecki
Sure. They are almost completely off-the-shelf. We have a standard product line that is used for nearly all of our customers. In very specific cases, we are happy to and comfortable making custom changes, but the lion's share of that is off-the-shelf.

With respect to installations, on the PG side of the business, nearly all the installations are conducted by the generator manufacturer/dealer partners that we have established over the past 20 years of our history, and they conduct nearly all the installations on the PG side of the business.

On the CP side of the business, it is typically our clients directly. They have their own in-house teams of service technicians that install the devices, and we make sure they have a positive experience from the time they start working with us so that they're properly trained and can install the units with ease and success.

Michael Rindos
What kind of margin do you capture on the units themselves?

Walter Czarnecki
On the units themselves, on the PG side, it's — it ranges across commercial investor and residential. It's around 40 percent on the PG side and around 30 to 35 percent on the CP side.

Michael Rindos
Okay, so it's definitely accounted for as a product sale with a 30, 35 to 40 percent margin. Okay. And what can you tell us about orders, backlog, time to install, that kind of thing?

Walter Czarnecki
Well, we continue to have a healthy backlog for leading into Q2, and the pace has been — what we have seen, and this is typical of every year, it's usually a slow start to the year because of weather events and just the winter and colder temperatures in general, that installations typically are highest in Q2 and Q3. Q1 and Q4 are typically slower in terms of pace of installations.

Michael Rindos
You weren't specific about the units, but can you give us any kind of indication as to what the ARPU is, in some kind of range? Are we talking about [inaudible]?

Walter Czarnecki
In terms of the range of —

Michael Rindos
—- [inaudible] 10 to 20 bucks, or what's —kind of ARPU are we talking about here?

Walter Czarnecki
In terms of the return on the —

Michael Rindos
The return on revenue, reoccurring service revenue on the units.

Walter Czarnecki
Sure. That's — well, it's higher on the commercial industrial side. That is in the $30 to $40 per month range. On the residential side, it's much lower; it's $10 to $20 per month.

Michael Rindos
And how does the mix break down between commercial and residential? And what's the application for residential? Is it alarm monitoring?

Walter Czarnecki
Yes. So on the breakdown between commercial industrial and residential, right now the — it's about a 60/40 split of residential to commercial industrial, and the need and the application for residential is following the trend of what we've seen generally in terms of smart homes. Homeowners are increasingly desiring of having more information about the equipment and facilities at their home, and that's just following what they've seen available with other appliances in the home. That's one piece.

The second piece is that typically these are folks that may have multiple homes, and they may not be at the home all the time, and so they want to know what's going on with the home when they're not there.

Michael Rindos
What percentage of the backhaul is wireless versus hard wired?

Walter Czarnecki
It is high 90 percent that is wireless. That's nearly all of what we do. We also offer a satellite option, which we have seen growing the most in the CP side, because, as you can imagine, the geographic expanse of the networks of the pipelines, that is increasingly more satellite focused, but in terms of the PG side of the business, that's nearly all cellular.

Michael Rindos
Okay. Thanks. I'll get back in the queue.

Operator
And our next question comes from George Sem of Trilogy. Please go ahead.

George Sem
Yeah, hi there. Good to visit with you again. Another — things are certainly moving in the right direction here. I'm real pleased with what I see for year-end here.

I wonder if you could talk a little bit about the cathodic protection and what's going on in that part of the arena.

Walter Czarnecki
Sure. So that is, as you can see, our fastest growing business, and that's really following the major trend that we have seen across all industries but specifically in oil and gas, where both gas utilities as well as large pipeline companies, are under increasing pressure to — of a couple factors. One, they need to continue to reduce costs and improve their efficiency. And, secondly, they need to improve accuracy of data and improve the compliance under which they're — they need to execute on through various state and local jurisdictions.

All of those factors combined are leading to them turning increasingly more to technology, whereas in the past, they were relying mainly on humans and service technicians to be essentially meter readers, and we continue to see that trend as growing, and we're continuing to see more companies and more utilities have increasing budgets for that, and so that's why we're quite bullish on that segment.

George Sem
All right. Thank you.

Operator
And, ladies and gentlemen, once more, if you have a question, please press star, then 1 at this time. It looks like we have a follow-up from Michael Rindos of Dawson James. Please go ahead.

Michael Rindos
Could you expand a little bit more on your potential external growth strategy in terms of where you might find the most relevant assets, either regionally or by subsector? Can you expand on that at all — size, by size?

Walter Czarnecki
I'm sorry — the external growth strategy?

Michael Rindos
Right, it sounded as though you were looking to pursue or acquire other small companies in this field or assets. Could you expand on what will be interesting to you?

Walter Czarnecki
Sure. It would — a couple of things would be interesting. One, the technology has to be complementary, and so as we think and look across the entire emergence of Internet of Things, as you've probably read, that means a lot of different things to a lot of different groups and people. And so it's very fragmented right now. Where we operate in the power generation sector as well as in oil and gas, we have a great deal of expertise in those areas, but they're both quite narrow in scope. And so one factor we'd be looking for are technologies that are complementary to those segments. So, for example, on the CP side, it would be are there other technologies and data points that we can monitor on the pipeline or on the pipeline's network? Within power generation, it would be what else is related to the back-up generator. As I'm sure you've seen with the emergence of microgrids and a more integrated grid landscape, there are other pieces of equipment that are connected to generators, and so are there technologies that would be complementary to that? That's one factor.

The second factor would be, obviously, the high value of recurring revenue in the services model, and so we'd be looking for a technology that would have an ongoing recurring service revenue base associated with it. So those are the — two of the biggest factors that we look at as potential opportunities.

Michael Rindos
Thank you.

Operator
And our next question today comes from Jack Mayer, a private investor. Please go ahead.

Jack Mayer
Hey, Jan, congratulations.

Jan Loeb
Thank you.

Jack Mayer
Jan, you don't own 100 percent of OmniMetrix right now, and the question is, is any thought being given to somehow shift the corporate structure and in some way merge OmniMetrix with the parent?

Jan Loeb
We [inaudible] —

Jack Mayer
Is there something else about the 20 percent that you don't own?

Jan Loeb
Yeah. The answer is we do think about it on a regular basis on both of those, both on the 20 percent and on the structure. The issue with the structure is that the $60 million of NOLs reside at the Acorn level, so that's an important factor to understand. But in total, I think one of the main things is we are looking to reduce costs, and we think we will be able to reduce costs in 2018 from where we were in 2017 on the corporate level as well, somewhat significantly. So while we try to do that — so maybe the — if we can reduce costs enough, the multiple structure would not really be that harmful.

And in terms of the 20 percent, it's something that we look at, and if we can do it, it most probably would be in conjunction with a greater structural move, maybe with an acquisition. At the same time we do an acquisition, we might reacquire the 20 percent, so it's something we certainly look at, and at some point, my guess is that it will occur.

Jack Mayer
Uh-huh. I guess the structure as it is also gives you the flexibility if, for whatever reason, you want to, to acquire a business that you don't necessarily want to merge into OmniMetrix immediately?

Jan Loeb
It certainly allows for that to happen, but our focus — our acquisition focus is something that would be synergistic with OmniMetrix.

Jack Mayer
So you would expect to integrate it into OmniMetrix?

Jan Loeb
Definitely. It might not be on Day 1, but it might be on Day 5, but it — that's the area that we're looking at, and we do see things out there that are very synergistic with OmniMetrix.

Jack Mayer
Can you give us some indication of the types of — the kind of pricing that you see for those complementary assets?

Jan Loeb
I would rather not.

Jack Mayer
Okay.

Jan Loeb
But recognize that we're — that we generally would not overpay for an acquisition, and also recognize that we are — our shareholder dilution of our existing shareholders is an important factor, and so we will be taking that into consideration as well.

Jack Mayer
Okay. Thank you very much.

Operator
Ladies and gentlemen, as a final reminder, if you'd like to ask a question, please press star, then 1 at this time.

Bill Jones
Hi, this is Bill Jones here. We do have a question coming from online.

Jan Loeb
Okay, Bill.

Bill Jones
I think this question is more for Walter, but — and you may have touched on some of this, but the question is, basically, can you tell us a — provide a little more color on the trends that you're seeing in the monitoring space that are giving you such optimism? For example, perhaps you could tell us a little bit about opportunities in PG or CP, such as your market penetration or opportunities there as well as opportunities outside of those segments.

Walter Czarnecki
Sure. So similar to my comments on the oil and gas segment, in terms of an increasing realization by large corporates and utilities that remote monitoring and further use of Internet of Things applications is necessary from an operational accuracy perspective as well as from a cost efficiency perspective, we're seeing that in segments outside of oil and gas. So thinking about power generation, we're seeing that in the grocery sector, we're seeing that in the financial services sector, we're seeing that in the pharmaceutical sector and several others. Those are just a few that come to mind that we've recently done work in. And corporations are increasingly seeing remote monitoring as one means to increase their efficiency at their operational level.

Operator
And this concludes our question-and-answer session. I would like to turn the conference back over to Jan Loeb for any closing remarks.

CONCLUSION

Jan Loeb
Thank you all for your interest in Acorn. I believe Acorn represents an attractive platform for building shareholder value. We feel we have taken big steps over the past two years in cutting costs, thinning up the balance sheet, and focusing the company. Now we are in position for the next phase of growth as a focused pure play in the IoT space. Our low cost structure and operating leverage will allow topline growth to translate to improved financial performance which ultimately is the driver of shareholder value.

I'm grateful for the support of our investors and pleased to speak with any shareholders or potential investors. Please contact our Investor Relations team to set up a call with me or to answer any questions that you may have. Thank you again for your time this morning. And, with that, Operator, we can end today's call. Thank you.

Operator
And thank you, sir. This concludes today's conference. We thank you all for your attendance. You may now disconnect your lines.