

Acorn Energy, Inc.

First Quarter 2019 Earnings Release and
Investor Conference Call

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CORPORATE PARTICIPANTS

Jan Loeb, *President and Chief Executive Officer, Acorn Energy*

Walter Czarnecki, *President and Chief Executive Officer, OmniMetrix*

Tracy Clifford, *Chief Financial Officer*

PRESENTATION

Operator

Good morning and welcome to the Acorn Energy Q1 2019 Earnings Release and Investor Conference Call. All participants will be in 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 call is being recorded.

I would now like to turn the conference over to Tracy Clifford, CFO. Please go ahead.

Tracy Clifford

Thank you, and welcome, everyone, to today's conference call. 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 operating and financial performance of the company in 2019 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 for growth. Forward-looking statements are based on management's beliefs as well as assumptions made using information currently available to management pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. There are no assurances that Acorn or OmniMetrix will be able to achieve their growth goals in 2019 nor in future years. The company also [inaudible] no obligation to disclose any revision to forward-looking statements to reflect events or circumstances after the date made. A full 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 our CEO, Jan Loeb. Jan?

Jan Loeb

Thank you, Tracy, and thank you all for interest in Acorn. Walter Czarnecki, CEO of OmniMetrix, will open our remarks with an update on OmniMetrix. Then Tracy Clifford, our CFO, will provide financial highlights, and then I will conclude with some remarks before we open the call for your questions. Walter?

Walter Czarnecki

Thank you, Jan, and thank you to everyone for joining today's call. We are pleased to report that during the first quarter 2019, OmniMetrix achieved continued revenue growth, adjusted gross margin improvement, and positive adjusted EBITDA. Revenue recognized for the quarter on a GAAP basis, was \$1,327,000, and cash-basis sales were \$1,316,000, an increase of 6 percent over the first quarter of 2018.

As many of you know, we focus on cash-basis sales to attract the growth for the business. We believe this measure is most reflective of performance of the company, given that in our filed financial statements, pursuant to GAAP, we recognize the revenue from our hardware sales and service contracts over three years for hardware and typically one to three years for service contracts, depending on each contract's term.

Our gross margin, adjusted to add back an inventory write-off for \$30,000, increased to 64 percent from 62 percent in the same quarter for the prior year. This is primarily due to strategic plans we initiated several years ago to maintain our competitive edge and to continue to offer the highest performing, highest efficiency products in the Internet of Things market. In addition to sales growth, delivering the most innovative products and improving margins remain priorities for us.

One of the drivers of our margin improvement relates to the ongoing deployment of our new Hero 2 [unintelligible] Monitor for the oil and gas market as well as our TrueGuard 2 Residential Generator Monitor. In addition to these two products, we have begun fulfilling initial orders for AIRGuard, our new industrial air compressor monitor. We are pleased with the performance of all three of these products thus far, as evidenced by feedback from our customers.

During the quarter, we continued to observe several macro trends in the IoT market that will serve as a platform for continued future growth. First, we're seeing a shift of increased awareness of the value of IoT in remote monitoring within the commercial and industrial markets we serve. When I first started working in IoT seven years ago, many of the responses we received from prospective customers were, "What is IoT? Why would I use it?" Companies were skeptical that an IoT platform provided real value to their businesses. However, in recent quarters, we've begun to see a shift from the, quote, "What is IoT?" response to, "I know we need it. We just don't know how to deploy it."

We're seeing evidence of this shift in the strategies of large U.S. businesses. For example, Stanley Black & Decker, a 175-year-old industrial company, has hired a vice president to oversee and deploy IoT and data science strategies across the company. As another example, I recently spoke with a senior executive at a large energy company and learned how they are working with us and others to deploy IoT across their business to drive innovation and efficiency. We expect to see this shift gain traction as more businesses understand how IoT can increase productivity and enhance risk management tactics.

The second macro trend we see driving the business is labor, as evidenced by turnover in the oil and gas and industrial markets as industry veterans retire and the next generation of data-hungry engineers take their place. This incoming generation is more familiar with data and how to leverage it and embraces remote monitoring and IoT to manage their businesses and assets.

Another labor trend we see is one I commented on in recent earnings calls, which involves the labor shortage of service technicians at generator service organizations. Tight labor markets and low unemployment have also inhibited our ability to expand our sales team. To address these challenges, we have broadened the scope of our sales training and development programs to recruit and attract untapped sales talent that might be new entrants to the IoT market. We've added two recent hires to our team and are optimistic that our planned actions will grow hardware sales which were relatively flat to the same period last year, with a 1 percent decline. This was due to the timing of a sizable order placed at the end of the first quarter of 2018.

One final note on the labor shortage. It is important to note that this shortage, coupled with the growing installed base of backup generators across the country, is driving generator service organizations to incorporate remote monitoring into their preventative maintenance contracts. We want to be there for our existing and potential customers to fill this need.

I'm happy to discuss any of these topics further in the question-and-answer session for anyone interested in learning more about the IoT awareness shift and why we are well positioned to deploy IoT. I encourage you to visit the blog section of the OmniMetrix website where my

colleagues and I have written more on this subject. Navigate to www.omnimetrix.net/blog or from the Omni homepage, click on the Blog section at the top of the screen.

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

Tracy Clifford

Thank you, Walter. In the first quarter, Acorn's revenue comprised revenue from our 80 percent-owned OmniMetrix [inaudible] was 10 percent, to \$1.3 million, driven by a 12 percent increase in our power generation segment revenue to \$996,000 in the first quarter of '19 and 2.5 percent revenue growth from our cathodic protection or pipeline segment, to \$331,000. Higher margin monitoring services revenue grew 19 percent in the first quarter of '19, while hardware revenue decreased slightly to \$561,000 in Q1 '19 compared to \$567,000 in the prior-year period. As Walter noted, this decline was due primarily to the timing of a sizable order at the end of the first quarter of '18.

Gross profit grew 10 percent, to \$821,000 in first quarter '19, in line with revenue growth. Gross profit in the first quarter of '19 was negatively impacted, as previously mentioned, by a \$30,000 write-down of product inventory that we have replaced with upgraded technology. Excluding this write-down, gross profit was \$851,000, or 14 percent higher than first quarter '18. And, likewise, adjusted gross margin was 64 percent in Q1 '19 versus 62 percent. The overall blended margin increase was principally the result of sales of next generation monitoring products in our Power Generation segment. These products provide better functionality for our customers and yield higher margins than previous versions.

Operating expenses of OmniMetrix were 9 percent higher at \$873,000 in first quarter '19 compared to \$800,000 in Q1 '18, primarily due to investments in personnel and R&D expenses for continued innovation. With revenue and gross profits growing faster than operating expenses, OmniMetrix reduced its operating loss slightly, to \$52,000 in Q1 '19, and that includes the inventory write-off, versus \$55,000 in Q1 '18. The operating loss adjusted for the add-back of the inventory write-off, would have been \$22,000, for an improvement of 6 percent.

Now, turning to Acorn consolidated results, Acorn was able to trim its corporate G&A by 33 percent, or \$104,000, in Q1 '19 to \$209,000 as compared to \$313,000 in Q1 '18. As a result of growth in OmniMetrix and lower corporate overhead, Acorn's consolidated operating loss decreased to \$261,000, including that \$30,000 write-off in Q1 '19 compared to \$368,000 in Q1 '18. Net loss attributable to Acorn's shareholders improved to \$237,000, or one penny per share, in Q1 '19 compared to \$1,222,000, or 4 cents per share, in Q1 '18. The same period in the prior year included a loss of \$829,000 related to the sale of our remaining interest in our DSIT subsidiary. Therefore, the operating loss is a more meaningful comparative metric.

Turning to cash flows, net cash and cash equivalents decreased by \$185,000 in Q1 '19 versus year-end December 31. Acorn used \$325,000 operating activity, including the net loss of \$261,000 plus working capital changes. Offsetting this was \$140,000 provided by OmniMetrix new accounts receivable credit facility, which is included in financing activity. The new accounts receivable line was put in place in March on more favorable terms. The line provides OmniMetrix with greater flexibility to manage cash requirements. Funding is based on the lesser of 75 percent of the eligible accounts receivable or \$1 million.

As of March 31, Acorn had cash and cash equivalents of approximately \$1.1 million, including a restrictive cash balance of \$299,000, and we also had \$140,000 outstanding on the AR line. We are required to maintain an average monthly outstanding balance of \$150,000 on the operating

line, which can vary with timing of payments and draws, so even though we had adequate cash for operations, we will continue to draw down to at least that \$150,000 required outstanding balance.

That concludes my overview, and let me now hand the call back over to Jan, Acorn's CEO. Jan?

Jan Loeb

Thank you, Tracy. To wrap up our prepared remarks, I want to reiterate that we continue to focus on driving topline growth at OmniMetrix and believe an average annualized growth goal of 20 percent remains realistic for the company going forward, recognizing there will be some variation. While we were a bit below this goal in 2018, we were a bit above it in the prior year. Reflecting seasonality, sales staffing, and customer and economic factors, we fully expect our growth rate will vary on a quarterly basis.

I should also note that the first quarter is generally our lowest revenue quarter each year. This results from the typically strong business activity we see in the December quarter as many customers seek to spend remaining budget dollars by year-end as well as the impact that winter weather and the preparation of new budgets have on our customers' ability to initiate new monitoring services in the first quarter of each year.

Walter mentioned some of the initiatives we are undertaking to support our growth goals, including expanding our sales and marketing efforts and continuing to invest in next generation product innovations. To this end, we do intend to make measured investments in expanding our sales efforts, particularly in the Power Generation segment, where we see substantial untapped opportunities.

Beyond our plans to expand sales efforts, we will continue to manage our operating expenses tightly at OmniMetrix and the public company's parent to ensure that we are operating on a cost-effective basis, while not inhibiting our ability to grow. These disciplines are intended to enable Acorn to progressively bring more of our sales and gross profit to the bottom line, progress that we were pleased to see reflected in our Q1 performance.

We continue to pursue opportunities for complementary M&A transactions; however, we have been challenged to identify businesses that are available on terms that would make sense for our shareholders. While this process continues in the background as we've mentioned, we are working to optimize the performance and maximize organic growth of the operating business which we already own, as that provides an excellent path for value creation.

Today's press release also references the S-1 Registration Statement we recently filed related to a possible shareholder rights offering, seeking to raise \$2.4 million. We are limited by regulation on what we can say other than to point investors to our S-1 and the press release, which announced this filing. A principal motivation to pursue the rights offering is to provide sufficient funding to repurchase the 20 percent of OmniMetrix that we don't currently own, as well as to support growth initiatives at OmniMetrix as specified in the Registration Statement. We are excited about the growth this additional funding will allow us to pursue without limitations of available capital.

So, with that, let's turn the call over to the Operator to take your 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 telephone keypad. If you are using a speakerphone, 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.

Our first question today comes from Richard Sosa. a private investor. Please go ahead.

Richard Sosa

Hey, good morning, guys. Nice to see the quarter. I'm a big believer in your products and value proposition. You guys offer what I believe — a collection of services that cannot be replicated by competitors. And now that you're investing more in growth, do you expect possibly going into new industries or any potential new products? I mean, I know you have technology that can get into several different businesses.

Jan Loeb

Well, Rich, I'll start with that, and then maybe Walter wants to chime in. We think that in the business lines that we currently have, there is sufficient growth, as Walter pointed out, for the long term. So I don't see going far afield from the businesses that we have. We think that there are additional products within the general categories of our customer base that we can add that will bring in additional revenue, so I think the focus really is on our existing customer base and kind of line expansion. So I would think the compressor monitor, to me, is just a line extension of the technology that we have. I don't feel that that's going afield to some new area, although it's a brand new product for us.

Walter Czarnecki

Yeah, Richard, this is Walter. Thanks for the question. I would echo and agree everything that Jan just said. One of the key factors that has made Omni successful over the years is that we spend a lot of time understanding the market and the applications where we currently operate so that we can be the best in the market and offer the best-in-class products. And that's what we feel we've done with the generator monitoring, and so there is plenty more in the market, just in the U.S., just in North America and elsewhere, for us to continue to grow, and that's what we're doing now and what we plan to do in the future.

With respect to compressors, we see that as a new market, an exciting market. We've had some initial success there and plan to continue to grow and learn and develop that market as well. All that being said, in concept, yes, we do want to expand, but we certainly want to make sure that we are winning and dominating the markets where we currently operate first.

Richard Sosa

Okay, and now that you have a lot of your products out there in the field, do you believe there's additional monitoring products or analytics or AI, anything you could incorporate into these current sensors that you have out there?

Jan Loeb

There is certainly more that we can do in terms of predictive analytics and AI. It's a matter of understanding that business model for our customers. And this goes back to some of my prepared remarks in that there is still a good bit of debate and questioning within our customers' organizations of how do we best optimize this, how do we best make use and make a business case out of predictive analytics and AI? We have continued to move in that direction, and we

plan to continue to move in that direction in the future, so we're happy with the progress so far on that.

Richard Sosa

Okay, and just my last question, because I noticed in the queue that you awarded some stock options to employees. I'm a big fan of that. Can you maybe talk more about that? Was this new hires or current employees?

Jan Loeb

Well, we want to make sure that everyone is invested equally and incented equally, and one of the key factors of our success has also been our culture. And that starts by our colleagues and our customers all knowing each other, and the options were a logical next step to make sure that everyone is on the same team from that perspective.

Richard Sosa

All right. Walter and Jan, thank you very much. I'm very excited, and, just as a shareholder, I'm okay with investing in the business, only buy something if it's interesting, but, I believe OmniMetrix is one of the most interesting things out there. So I'll obviously express that. So thank you very much.

Jan Loeb

Thank you, Richard.

Operator

Once again, if you have a question, please press star, then 1.

Bill

Operator, this is Bill. We do have a question that was sent in via email.

Operator

Yes, please proceed.

Bill

So the question — I'll summarize. I think it's intended for Walter, but you touched on opportunities in the Power Generation segment, and maybe you can give us specifically, maybe more color on that as well as if you can help understand the size of the market and the opportunity, maybe the penetration or market share, things that of that nature would be helpful.

Walter Czarnecki

Sure. So as I mentioned earlier with Richard's questions, we see a great deal of potential yet to go within the power generation market. If you look at the market overall, in 2017, it was roughly a \$2 billion addressable market just in the U.S. in 2017 as it relates to backup generators. So far what we've seen among OmniMetrix and our various competitors, there's been about a 10 to 15 percent penetration rate there. So there is significant potential left for the market to develop, and that is a big driver why, as Jan said and I said, that we are continuing to expand and invest in more sales and marketing efforts and looking to drive the organic growth in that market.

Operator

And this is the conference operator. I'm not showing any further questions from the telephone, so I would like to turn the call back over to Jan Loeb for any closing remarks.

CONCLUSION

Jan Loeb

I would like to thank everyone for your interest in Acorn. I am grateful for the support of our investors, and I'm always pleased to speak with anyone who has questions about the company or our strategic direction. Just contact our Investor Relations team with any questions or to set up a call with me. Thank you again for your time today. And, with that Operator, we can end this call.

Operator

Thank you, sir. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.