

Acorn Energy

Q2 2019 Earnings Release/Investors
Conference Call

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CORPORATE PARTICIPANTS

Tracy Clifford – *Chief Financial Officer*

Jan Loeb – *Chief Executive Officer,*

Walter Czarnecki – *Chief Executive Officer, OmniMetrix*

PRESENTATION

Operator

Good day, everyone, and thank you for holding. Welcome to Acorn Energy's Second Quarter 2019 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 and then two. Please note that this event 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 are 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 undertakes no obligation to disclose any revisions 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 Walter Czarnecki, the CEO of OmniMetrix. Walter?

Walter Czarnecki

Thank you, Tracy, and thank you to everyone for joining today's call. We are pleased to report that during the second quarter 2019 OmniMetrix achieved continued revenue growth, improved gross margins, and an operating profit. Revenue recognized for the quarter on a GAAP basis was \$1.377 million and cash basis sales were \$1.468 million, an increase of 8% over the second quarter of 2018.

As many of you know, we focus on cash basis sales to track the growth of 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 power generation division sales on a cash basis grew by 21% over the prior year period and we remain confident of continued growth at that level. Our smaller Cathodic Protection division sales on a cash basis declined by 35%, which we attribute to the loss of multiple sales people in that division. In recent weeks, we have made several new sales hires, which we believe will bring our Cathodic Protection sales back in line with historical and projected growth rates.

Our gross margin increased to 65%, from 60% in the same quarter of the prior year. As discussed during the previous quarter's earnings call, this margin improvement is primarily a result of our strategy to deliver new, innovative hardware and software products to the industrial IoT markets we serve.

As part of that strategy, we continue to ship and install more of our Hero 2 Rectifier Monitors and our AIRGuard industrial air compressor monitors over the quarter. We've received positive customer feedback on both products, which further confirms we are meeting and exceeding the needs of the emerging IoT market, and delivering an excellent customer experience.

Regarding market adoption of IoT technology broadly, we continue to see more industrial companies recognize that IoT is not only a trend that requires their awareness, it must be a key priority for them. For example, last month I met with one of our industrial customers, as I do on a regular basis, and the owner relayed to me that one of his company's top three priorities for 2019 is to integrate IoT and OmniMetrix products into their business. We expect to see this adoption continue in the coming quarters and years.

To hear more about the growth of IoT and our leadership position in it, please join us at the AT&T Business Summit in Dallas, Texas on November 4-7 of 2019. This is AT&T's annual showcase event that attracts over 4,000 technology leaders. I will be speaking on IoT and how we are shaping that market.

I'm happy to discuss these topics further in the question-and-answer section. 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 home page, 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 review financial highlights.

Tracy Clifford

Thank you, Walter. As you are aware, since February 2018, OmniMetrix has been Acorn's only subsidiary, so 100% of Acorn's revenue was generated by OmniMetrix in the second quarter of 2019. We're pleased to share that OmniMetrix's revenue in 2019 grew 12% to \$1.4 million, driven by a 20% increase in our power generation segment revenue, which was disappointingly offset by a decline in the revenue in our Cathodic Protection or pipeline segment of 8%.

This decline compared to 2Q 2018 to 2Q 2019 was due to the timing of two large orders, and as Walter mentioned, to our sales team being less than 100% staffed during the current year period. Likewise, for the first half of 2019, revenue grew 11% in the aggregate, with 16% growth in the power generation segment offset by a 3% decline in the Cathodic Protection segment.

Higher margin monitoring services revenue grew 22% in 2Q 2019, while hardware revenue was flat compared to the prior year period. The increase in monitoring revenue was driven by a significant increase in monitoring revenue, resulting from the increased number of units being monitored as a result of focused sales initiative on the industrial and commercial markets.

Gross profit grew 22% to \$901,000 in 2Q 2019, significantly exceeding the rate of overall revenue growth. The increase in gross profit compared to the first six months of 2018 were attributable to increased revenue, increased margin on hardware sales, and a more favorable product and sales mix, as monitoring provides a higher gross margin versus hardware sales. As a result, as Walter

mentioned, gross margin improved to 65% in 2Q 2019 versus 60% in 2Q 2018.

Operating expenses of OmniMetrix were 6% higher at \$861,000 in 2Q 2019, compared to \$814,000 in 2Q 2018, primarily due to investments in personnel in IT, customer service, and engineering to strengthen our competitive infrastructure, and some additional R&D spend for continued innovation.

When comparing operating costs from the first quarter to the second quarter of 2019, operating costs were slightly down in the second quarter. We expect that we will have increased operating costs in the future as we invest in the expansion of our sales team and in our IT system.

With revenue and gross profit growing significantly faster than expenses, OmniMetrix reported an operating profit of \$40,000 in 2Q 2019 versus a loss of \$78,000 in 2Q 2018. For the first half of 2Q 2019, OmniMetrix reduced its operating loss by over 90%, to \$12,000 from \$133,000 in the first half of 2018.

With respect to Acorn's consolidated results, Acorn reduced its corporate G&A by nearly 50% to \$243,000 in the second quarter of 2019, reflecting cost reductions, including a material reduction in personnel costs, board fees, and other public company costs over the prior year period.

As a result of growth at OmniMetrix and lower corporate overhead, Acorn's consolidated operating loss decreased 63% to \$203,000 in 2Q 2019 compared to \$544,000 in 2Q 2018. Net loss attributable to Acorn's shareholders improved to \$199,000, or 1% per share in 2Q 2019, compared to \$538,000 or \$0.02 per share in 2Q 2018.

For the first half of 2019, net loss attributable to Acorn's shareholders was \$436,000, or \$0.01 per share versus \$1.8 million or \$0.06 per share in the first half of 2018. First half of 2018 did include a loss of \$829,000, or \$0.03 per share on the sale of Acorn's remaining interest and DSIT. As it relates to our cash flow on a consolidated basis, Acorn used cash of \$423,000 in operating activities during the first half of 2019 versus \$1.9 million used in the first half of 2018. Of that \$423,000 used this year, \$81,000 related to OmniMetrix operations and \$342,000 related to corporate expenses.

As you may recall from our first quarter conference call, we put in place a new accounts receivable line in March of this year with more favorable terms, which allows OmniMetrix greater flexibility to manage cash requirements. We're required to pay interest and service charges on a minimum average monthly balance of \$150,000, regardless of the amount outstanding.

At June 30, 2019, OmniMetrix had \$191,000 outstanding on the credit line and \$312,000 was available to borrow. Acorn had cash and cash equivalents of approximately \$2.9 million, excluding restricted cash of \$304,000, which is currently being held at a bank in Israel, as of June 30, 2019.

As of August 9, after giving effect to the repurchase of the 19% OmniMetrix stake, Acorn had cash and cash equivalents of approximately \$1.577 million, again excluding the \$304,000 of restricted cash.

That includes my review of the results, and now I'll pass the call over to Jan Loeb, Acorn's CEO. Jan?

Jan Loeb

Thank you, Tracy. On our last call, I mentioned that we had filed for a rights offering and that we were excited about the growth that this additional funding will allow us to pursue. We not only closed that deal before the end of the quarter, raising \$2.4 million in gross proceeds, but also we accomplished the repurchase of 19% of OmniMetrix, which Acorn did not already own. We were able to do this at a price based on the original 2015 transaction plus accrued dividends, which I feel is very beneficial for our

shareholders. And an additional benefit is that the remaining funds provide growth capital for our OmniMetrix business, which has been growing, despite being capital constrained, and successfully transitioned to an operating profit in Q2 from an operating loss in Q2 2018.

We will continue to focus on driving top-line growth at OmniMetrix and believe an average growth goal of 20% is attainable for the company going forward, recognizing that we have been below that level in the first half of 2019. Obviously, there will be some variation. We do expect the second half to be stronger, particularly in the December quarter.

We also believe that some of the initiatives we are now implementing will begin to have an impact by Q4. We have mentioned some of these initiatives we are undertaking to support our growth goals, including expanding our sales and marketing efforts, and continuing to invest in next-generation product innovation.

To this end, we do intend to make measured investments in expanding our sales efforts in both of our product segments.

Beyond our plans to expand sales efforts, we will continue to manage our expenses prudently, both at the operating company and at the parent level, while not inhibiting our growth. As you can see in our Q2 results, we have reduced our consolidated net loss by 63% in the past year while continuing to grow the company. We feel strongly that continued top and bottom line improvement is a lever for building shareholder value. The OmniMetrix business, with its strong growth, high margins, and recurring revenue model, provides an excellent opportunity for building such value. We will also consider any opportunistic M&A opportunities that may be value accretive. For example, purchasing the 19% of OmniMetrix at 2015 pricing, which we accomplished on July 1.

We like this business and prefer to own more of it, and we feel this transaction benefits shareholders, particularly now that OmniMetrix is transitioning from operating losses to operating profits. It also makes sense to own all of it to invest in its growth.

With that, I would turn the call back to the operator so we can take questions from investors.

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 telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star, then two. At this time, we will pause momentarily to assemble our roster. And again, if you have a question, please press star, then one.

There are no questions in the queue. This concludes our question-and-answer session.

I would like to turn the conference back over to Jan Loeb for any closing—excuse me, we have one. We have a question in the queue, Michael Zuk from Oppenheimer. Please go ahead.

Michael Zuk

Just to refresh my memory with regard to the efforts going forward to build the business, are our product lines mainly focused on retrofitting existing systems, or do our product lines come into the creation of new systems in the building of new systems? I guess I'm saying, are we an OEM supplier?

Jan Loeb

Walter, why don't you take that question, please?

Walter Czarnecki

Sure. Good morning, Michael. This is Walter. In both of our divisions we focus on both new construction opportunities, as well as retrofit. So if you look at the power generation market, we are installing monitoring on newly installed generators, as well as older models. And similarly in our Cathodic Protection division, we're installing on existing gas pipelines, as well as new pipeline builds.

Michael Zuk

Can you give us a little bit of a breakdown between the two, is it like 50/50 or 60/40?

Walter Czarnecki

The majority of it is existing, just because of both of those markets have such a large existing installed base of equipment, so there is plenty out there to retrofit. That being said, we focus on the new build as well.

Michael Zuk

And then from the regulatory side, are there increasing regulations with regard to monitoring of these types of the projects?

Walter Czarnecki

Similarly, we are seeing increased regulations on both sides of the business. So on power generation, we are seeing more regulations as it relates to healthcare facilities, and as we've seen over the past couple of years with hospitals and nursing homes and other healthcare facilities losing power at critical times during hurricanes and various weather events, we've seen increased reporting requirements on those facilities to have multiple tiers of backup power ready. And we're playing an active role in doing that, specifically on the reporting side, because these facilities are required by law to put forth various reports that they have in fact met those requirements, and we're currently offering that reporting as a service to our customers and receiving revenue for it.

On the Cathodic Protection side, there have been regulations in place that require various inspections along the pipelines, and that has been one of the key drivers for the business to-date. Everything that we're hearing—in fact, I had a conversation with one of our colleagues just yesterday about this that we're hearing about more regulations expecting to be in place in the months and years ahead. So that remains a key driver for both divisions of the business.

Michael Zuk

Well, thank you for these explanations. It's very helpful to understand the basics of our business and the opportunities going forward, and I appreciate it.

Walter Czarnecki

Great. Thanks.

CONCLUSION

Operator

Again, if you have a question, please press star, then one. There are no other questions in the queue. Therefore, I would like to turn the conference back over to Jan Loeb for any closing remarks.

Jan Loeb

Thank you. Once again, I thank everyone for your interest in Acorn. We genuinely appreciate the

support of our investors, and I'm always happy to speak with investors who have questions or concerns about the company or our strategic direction. Please reach out to our Investor Relations team with any questions or to set up a call with me, and thank you again for your time today.

Operator, that should conclude today's call.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect, and I hope you enjoy the rest of your day.