

Acorn Energy, Inc.

Q3 2019 Results Conference Call

Friday, November 15, 2019, 11:00 A.M.
Eastern

CORPORATE PARTICIPANTS

Walter Czarnecki - *Chief Executive Officer, OmniMetrix*

Tracy Clifford - *Chief Financial Officer*

Jan Loeb - *Chief Executive Officer, Acorn Energy*

PRESENTATION

Operator

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

I would now like to hand 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 or in future years.

The Company also undertakes no obligation to disclose any revision to these 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.

Now, with that, I will hand the call over to Walter Czarnecki, the CEO of OmniMetrix. Walter?

Walter Czarnecki

Thank you, Tracy, and good morning to those joining our call today.

During the third quarter 2019, OmniMetrix again achieved revenue growth, improved gross margins, and a second consecutive quarter of positive operating profit. Q3 revenue rose 4% to \$1,386,000 and cash basis sales for \$1,614,000, an increase of 8% over the third quarter of 2018.

As many of you know, cash basis sales is a performance tracking measure we use to supplement revenue reported in our financial statements. Pursuant to GAAP, we recognize revenue from our hardware sales over three years and typically one year for our monitoring contracts, even though the cash is generally received upfront. Cash basis sales therefore provides visibility on the current level of business that was completed in a period and growth trends.

Our Power Generation division sales on a cash basis grew by 17% over Q3 of 2018, and we remain confident of continued growth at that level or better. In our smaller Cathodic Protection division, which focuses on monitoring and control of gas pipelines, sales on a cash basis declined

by 37%, which we attribute to the impact of turnover in the division's sales staff. In Q3, we completed several new sales hires, which we believe have the potential to return our Cathodic Protection sales to historical and projected growth rates in coming quarters.

Despite the disruption in our CP sales team, we have built a solid pipeline of customer trials in Cathodic Protection. The new team members are making excellent progress as they have ramped in recent months, and we expect their growth and impact to continue. For example, we currently have four times the number of customer trials in progress than we had at this time last year.

Moving to our Power Generation division. Historically, our business has been favorably impacted by natural disasters that disrupt consumer power systems. The catastrophic fires in California represent the type of disruption that we believe could drive demand for standby generator purchases, along with our monitoring services. Historically, California has not been as strong generator market given its relatively mild weather and temperatures. We have seen a meaningful increase in demand for generators and generator monitoring, following extreme weather events in the U.S. and Caribbean. As a result, we expect that this unfortunate situation will spur demand in California and neighboring states, and we work to bolster our sales and marketing efforts to pursue these opportunities. I would add that this week, I am in Santa Clara, California, where we exhibited at the IoT Tech Expo. I spoke with several people this week who asked about generator monitoring for fire departments, municipalities, and other applications.

Moving to gross margins, our gross margin increased to 66.5% in Q3 from 62.2% in the prior year period. This margin improvement is primarily the result of actions we have taken over recent years to develop and deliver new, innovative hardware, and software products that offer both, enhanced functionality as well as more efficient lower cost designs. As part of our strategy of delivering higher value, higher margin next generation products, we continue to ship and install more of our Hero 2 Rectifier Monitors, and our AIRGuard industrial air compressor monitors. These products are meeting and exceeding customer expectations, and we continue to receive very favorable reviews of these products.

Regarding market adoption of IoT technology broadly, we continue to see growing awareness, appreciation and acceptance by industrial companies of the value and reduced costs that IoT solutions can provide, and a steady growth in companies that view IoT as a key priority.

To that end, last week, I presented an IoT case study of one of our pipeline monitoring clients at AT&T's annual showcase event, the AT&T Business Summit in Dallas. The case study I presented was of a pipeline monitoring client that had found a range of benefits from IoT-based monitoring and controls. In addition to meaningfully lower ongoing monitoring costs enabled by wireless connectivity, they also benefit from 24/7 monitoring of a broader array of factors as well as enhanced reporting capabilities.

I am happy to discuss any of these topics further in the question-and-answer section. I also encourage you to visit the blog section of the on the OmniMetrix website where my colleagues and I write on the IoT market, market adoption, real world applications and more on this subject. Navigate to www.OmniMetrix.net and click on the Blog section at the top of the screen. Please also engage with us on Twitter where we work to socialize news and customer case studies.

Now, I will turn the call over to our CFO, Tracy Clifford, to review financial highlights. Tracy?

Tracy Clifford

Thanks, Walter. OmniMetrix revenue grew to \$1.4 million in Q3 2019, up from \$1.3 million in Q3 2018. Power Generation, our largest segment, grew by \$159,000 or 17% to \$1.1 million. This was partially offset by a 27% decline in revenue in our smaller Cathodic Protection or CP segment to \$296,000. The decline in the CP segment was primarily due to the turnover in the sales team in that area which resulted in as not being fully staffed in the period in this segment. Similarly, for the year-to-date period through September of 2019, revenue grew 8% in the aggregate, driven by a 16% or \$445,000 increase in Power Generation revenue, which was partially offset by a \$131,000 or 12% decline in revenue from the Cathodic Protection segment.

Higher margin, recurring monitoring services revenues grew 23% in 3Q 2019, while lower margin hardware revenue declined 70% compared to the prior year period. The increase in monitoring revenue was driven by a larger total number of units being monitored as a result of focused sales initiatives on the industrial and commercial markets. Overall, gross profit grew 11% to 922,000 in 3Q 2019, significantly exceeding the rate of revenue growth.

The increase in gross profit was attributable to increased revenue, increased margin on hardware sales, and a higher percentage of monitoring revenue as monitoring provides a higher margin than hardware sales. As a result, gross margin improved as previously mentioned to 66.5% in 3Q 2019 versus 62.2% in 3Q 2018. Total operating expenses of OmniMetrix, including R&D, were essentially flat at \$816,000 in 3Q 2019 compared to \$810,000 in 3Q 2018.

We expect we will have managed increases in operating costs going forward as we invest in the expansion of our sales teams and in our IT systems. With revenue and gross profit growing faster than expenses, OmniMetrix reported a solidly higher operating profit of \$106,000 in 3Q 2019 versus an operating profit of \$21,000 in 3Q 2018. Through the first nine months of 2019, OmniMetrix generated an operating profit of \$94,000 versus a loss of 112,000 in the prior year period.

With respect to Acorn's consolidated results, Acorn reduced its corporate G&A by 10% to \$227,000 in 3Q 2019 compared to \$251,000 in 3Q 2018, reflecting our efforts to reduce personnel costs, board fees and other public company costs over the prior year. As a result of growth in OmniMetrix and lower corporate overhead, Acorn's consolidated operating loss improved to \$121,000 in 3Q 2019 compared to a loss of \$230,000 in 3Q 2018.

Net loss attributable to Acorn's shareholders was \$121,000 or \$0.00 per share on a rounded basis in 3Q 2019 compared to net income of \$4,000 or \$0.00 per share in 3Q 2018, which included a gain of \$222,000 or \$0.01 per share related to the sale of our interest in DSIT in the 2018 period.

For the nine months ended September 30, 2019, net loss attributable to Acorn's shareholders improved to \$557,000 or \$0.02 per share versus a net loss of \$1.8 million or \$0.06 loss per share in the first nine months of 2018. The prior year period included a loss of \$607,000 or \$0.02 per share on the sale of Acorn's prior interest in DSIT.

Turning to cash flow on a consolidated basis, Acorn used cash of \$933,000 in operating activities during the first nine months of 2019 versus \$2.3 million used in the first nine months of 2018. Of this \$933,000, \$290,000 of that amount related to OmniMetrix operation and \$643,000 related to Acorn corporate expenses.

As of November 9, 2019, OmniMetrix had \$147,000 outstanding on its AR line. Also, as of November 9th on a consolidated basis, Acorn had cash and cash equivalents of approximately

\$1,333,000, excluding \$311,000 restricted cash held in a bank in Israel, which we expect to be released by your end.

That concludes my overview of the results. And I will now pass the call over to Jan Loeb, Acorn's CEO. Jan?

Jan Loeb

Thank you, Tracy. On previous calls, we have discussed our rights offering, which closed at the end of Q2 with gross proceeds of \$2.4 million. As of July 1st, or the beginning of our third quarter, we repurchased a 90% stake OmniMetrix, bringing our ownership to 99%. We believe this purchase represents a very attractive and value-creating transaction for our shareholders, as was priced based on the value of the business back in 2015, plus accrued dividends, and it did not reflect the growth in operational progress we have made over the past four years. As Walter mentioned, OmniMetrix has turned the corner from operating losses to operating profits, and now Acorn owns 99% of that business.

With greater ownership, it makes even more sense to invest in OmniMetrix's growth and success. Walter touched on the fact that we are investing in product development and sales resources, and we will continue to do so in order to support profitable growth opportunities. We are also considering tuck-in acquisitions that would spur our growth and profitability. I know that I have mentioned acquisitions before, but in the past, we were looking at perhaps a transformational deal. Now, we are focused on small opportunities that could fit easily into the OmniMetrix business.

Given our solid cash position, improving profitability metrics, and financial discipline, we can afford to be patient in seeking the right fit. We will do a deal if and when there is a good opportunity that benefits shareholders. Keep in mind that we have a large NOL to shelter us from future taxes. So, accelerating our path to profitability and accessing this tax shield would be beneficial to the company and our shareholders.

First, we have to cover our costs, including corporate costs, and as you can see in our Q3 results, we are getting closer, but are not quite there yet, but our goal is to reach consolidated breakeven sometime next year and we feel we have financial resources available to do so. So, far in 2019, we have formed below our annual growth goal at OmniMetrix, and as Walter mentioned, some of that is related to turnover in our sales team, which was not fully staffed for part of the year. We filled two positions and expect to add more resources to the sales team over the next few months.

We feel these investments in sales as well as continued investments in product development will help us return to our 20% top-line growth goal. Beyond plans to expand sales efforts, we continue to manage our expenses prudently. As you can see in our Q3 results, we have reduced our consolidated net operating loss by about 50% in the past year while continuing to grow the company. We feel that continued top and bottom line improvements are the path to building shareholder value and the OmniMetrix business with its growth, high margins and recurring revenue model provides a vehicle for building such value.

We thank you for your support in this journey, and with that, I will turn the call back to the operator, so we can take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

Yes. We will now begin the question-answer-session. To ask a question, you may press star (*) then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*) then two (2).

Again, if you have a question, please press star (*) then one (1). Our first question will be from Richard Sosa, an investor.

Richard Sosa

Hello. I just had a couple of questions. You somewhat mentioned this in the release. So, the corporate expense you do plan over the next few quarters to stick around the \$230,000 range, like this quarter. Is that correct?

Jan Loeb

Yes. I think that is rough range.

Richard Sosa

Okay. And then, maybe this question is for Walter or Jan, whichever feel more comfortable. So, on the four times more customer trials in the CP segment, is the third quarter usually the quarter that has the most trials per se or is it four times off the peak base or is third usually light on customer trials?

Walter Czarnecki

Good morning Richard. It is Walter. In terms of trials, we see trials happening throughout the year. So, while we have seen seasonality in the CP business, typically in the second half of the year, with respect to purchases, trials we see throughout the year.

Richard Sosa

Okay, and on the AT&T conference, was there a time one of those standing room only, and was there a lot of good questions and potential customers? Did you mean anyone that could be a good fit going forward for that particular segment?

Walter Czarnecki

It was a great event from the perspective of raising awareness, not only of the OmniMetrix brand, but also of remote monitoring and IoT in general. As you have heard me say in recent and previous calls, our biggest competitive threat is not so much our other competitors out there, it is really general awareness of customers. Too many companies still do not know about remote monitoring, still do not know about IoT, and so, the business summit last week, as well as the IoT Expo this week are both good vehicles to get our name out there and raise awareness.

In addition to the panel that I spoke on at the AT&T business summit, they recorded that, and we did several interviews just with myself and for OmniMetrix, and so, we expect to see that in 2020 packaged into a good bit of content and social media from AT&T. So, we look forward to spreading that content as well, next year.

Richard Sosa

Okay, my last question is just on the CP segment again. Obviously, it has been a rough year for that segment, but do you feel confident that you would be able to get back to historical 30% to 40% growth rate in that segment for 2020?

Walter Czarnecki

We certainly feel we can improve from where we are and get back to historical growth rates. The major disruption has been, as we mentioned, the turnover in sales staff. The two folks that we have hired are doing great work, they are both very familiar with the field, they are young, they are hungry, they are professional, and as you have seen from the trials, they have already put in some great performance so far, and we are expecting more from them.

From a product and experience perspective, customers are still very happy, and we are continuing to build on that good reputation that we have in the market.

Richard Sosa

Okay, and then just, I am sorry, one more and I will get back in the queue. Just on the PG segment in California. Do you guys do any business there today and do you expect that-you mentioned, it was kind of a slow, not a huge market for generators, but I did notice on the Generac call, they talked a lot about it. Do you have customers there today and do you expect there to be continuing awareness in growth in that state and neighboring states?

Walter Czarnecki

We have been doing work here for a few years. It has been marginal, given the distance from our office in Georgia, and if you look at customer base, it generates from there and extends further out. So, on the other side of the country, it is more marginal than we would want. We see certainly the growth and activity of the generator OEMs as a key demand factor for us. So, the fact that Generac has been so busy here in recent weeks and months is a good sign for us, and many of the folks who I spoke with at the expo this week are focused on just getting generators in first, and that is what we have seen in the past in Florida and Puerto Rico and other places where the first wave is we need to get the generators in; and then, the second wave is, how are we going to monitor them, how are we going to capture data about them? So, that is what we are expecting in California as well.

Richard Sosa

Okay. Thank you.

Operator

Our next question comes from Dan August, a private investor.

Dan August

Yes. Could you elaborate a little bit more on the loss of the sales force, the departures of those salespeople? What drove them to leave the company? Why are you so confident that you are going to be able to replace them? And it seems like it was a big factor, but really do not know any of the circumstances leading up to that. I appreciate some explanation.

Walter Czarnecki

Sure. Good morning Dan. It is Walter. I would say first of all, the departure of two of the salespeople that have left were solely based on my decision, and that was driven by the desire to upgrade the performance of that sales team. We have already replaced both of them, and as we have mentioned, very happy with both of the two newcomers who are already well underway of bringing in customers and new business.

Dan August

Great, thanks. Thanks very much.

Operator

As we have no further questions, this will conclude our question-and-answer session. At this time, I would like to turn the conference back over to Jan Loeb for any closing remarks.

CONCLUSION

Jan Loeb

Once again, I would like to thank everyone for your interest in Acorn. We appreciate the support of our investors. And I am always happy to speak with investors or prospective investors who may have any questions or concerns about the Company or about our direction. Please reach out to our Investor Relations team with 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.