Acorn Energy, Inc.

Second Quarter 2020 Conference Call

Thursday, August 13, 2020, 11:00 A.M. Eastern

CORPORATE PARTICIPANTS

Tracy Clifford – *Chief Financial Officer & Chief Operating Officer OmniMetrix*

Jan Loeb – *Chief Executive Officer*

PRESENTATION

Operator
Good day, everyone. Thank you for holding and welcome to Acorn Energy's Second Quarter 2020 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, this event is being recorded

I would now like to hand the conference over to Tracy Clifford, CFO of Acorn Energy and COO of its OmniMetrix subsidiary. 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 maybe forward-looking. These statements are subject to various risks and uncertainties. For example, the operating and financial performance of the company in 2020 and future years is subject to factors, such as risks associated with disruptions to business operations and customer demand resulting from the impact of the COVID-19 pandemic; executing the company's operating strategy, maintaining high renewal rates, growing our 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 2020, nor in future years. The company also undertakes no obligation to disclose any revisions 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.

I will now hand the call over to Jan Loeb, CEO of Acorn. Jan?

Jan Loeb
Thank you, Tracy, and good morning. In our second quarter, Acorn achieved 7% year-over-year revenue growth, a gross margin of 70% and we approach breakeven on a consolidated net income basis with a net loss attributable to Acorn shareholders of $33,000 or $0.00 per share. This is the best bottom line operating performance that we have achieved in many years and it was achieved during the pandemic, but these results I am optimistic about for the future of our business and proud of our OmniMetrix team. I would like to take this opportunity to publicly thank our entire OmniMetrix team for their individual and collective efforts over the past several months as we work through the challenges of COVID-19 both personally and professionally.

As a company, the health and safety of our employees and customers is paramount as we continue to adhere to CDC guidelines in our daily operations in our 21,000 square foot facility and at client sites. Our business, which provides remote monitoring control services for equipment and infrastructure support, for government, healthcare and other critical services is classified as essential by the state of Georgia. As such, we have remained fully operational throughout the pandemic without any employee furloughs.

We started the year with a bullish outlook for growth but by the end of Q1 and into early Q2, we were seeing lower sales volumes mainly due to reduced hardware sales activity as businesses were either closed or focused on other aspects of their operations and attempting to function successfully through the pandemic.

As many of you know cash basis sales, is a performance tracking measure we use to supplement our GAAP reported revenue and revenue growth trends. Cash basis sales are different from GAAP revenue because we defer and recognize revenue from hardware sales over a 3-year period and we defer and recognize revenue from margin contracts over the period of service, which typically is 1 year. We invoice upon hardware shipments and monitoring renewal periods, which creates the difference between cash sales and GAAP recorded revenue. Cash sales gives insight on the volume of business closed in a period.

In Q2, 2020 cash basis sales was essentially flat at $1.47 million as compared to $1.468 million in Q2 2019. We are satisfied with this result, because we are able to maintain our sales volume level despite very challenging business development conditions caused by COVID-19 and related shutdowns and delays.

In our biggest segment, power generation, which focuses on the monitoring of standby generators for commercial and residential accounts, our cash basis sales increased $77,000 or 6% in Q2 2020 over Q2 2019. In our small Cathodic Protection or CP segment focused on the monitoring and control of the electric current running in gas pipelines, cash basis sales declined by $75,000 or 31% due to restrictions on travel and sales interactions. In the CP segment, our clients have generated larger corporations, where in many cases sales meetings have been postponed due to social distancing and other restrictive policies currently in place. Additionally, CapEx budgets in the CP segment are also being impacted by energy price volatility and supply and demand disparities that continue to negatively impact this business.

Prior to the COVID disruptions, our expanded sales team was making considerable progress building a solid pipeline of customer trials. The sales cycle in the CP segment is typically 12 to 18 months, but it's likely to lengthen in many cases due to meeting and travel restrictions. However, we remain focused on converting these customer trials into deployments over time. Now more than ever, remote monitoring control has a very compelling value proposition as our technology and services enable our customers to manage mission-critical industrial equipment, much more cost effectively and safely as we can substantially reduce the number of people and travel required to manage disparate assets over wide areas. These benefits are gaining even greater appreciation with mandated personal safety requirements, travel limitations, social distancing mandates related to the pandemic. In addition to the increasing frequency of severe weather events, we believe this equips us with even more fact-based justification to the need and benefits of our products and provides a substantive platform to support our expanding sales and marketing efforts, particularly given the very low penetration of remote monitoring and control solutions in our target markets.

Now, let's turn back to a few financial highlights after which Tracy will provide more specifics to our financial performance and position and then we will open the call to your questions. I mentioned that we have achieved 7% revenue growth over Q2 2019 and a gross margin of 70%. Most significantly, our gross profit grew 13% in Q2 2020, outpacing revenue growth due to the strength in our high margin recurring monitoring services revenue, which grew 19% in the quarter.

This performance underscores the attractiveness and resilience of our monitoring service business and the strategy we have been executing for the past few years to refocus Acorn's resources on building this compelling business.

Turning to business development initiatives in the second quarter, we launched our new Smart Annunciator product, which provides customers with status updates on critical electric systems and last month, we forged our first distribution relationship outside of North America, targeting Continental Europe with the Italian company, Mel Systems, which will market our AirGuard monitoring solution in Italy as well as other countries in Europe. It will take some time to build out this distribution relationship and to customize our solution for the European market, but we believe this is an exciting new growth opportunity for our company. We also hope to launch a new OmniMetrix software product upgrade later this year, which will offer more features and value to our customers solidifying our leadership position in the remote monitoring and control market and we will have more to say after the launch.

In the meantime, despite the COVID-related business development challenges in the near-term, we see an abundance of market opportunities. Historically, new standby generator monitoring sales have been positively impacted by natural disasters and emergencies such as hurricanes and storms that disrupt power system and highlight the importance and value of standby power and remote monitoring to ensure generators can be relied upon to be called into service without delay and to operate for as long as necessary without interruption. Similarly, we believe the pandemic can also stimulate generator and remote monitoring demand as reliable electrical access for home offices has become more important.

Some of you may have been impacted by the tropical storm that went up the East Coast last week. Although not a hurricane, this storm left millions of people without power, some for upwards of a week. We expect the aging of the U.S. power grid infrastructure will continue to be an issue and a driver of backup power generation and monitoring for many years. This is one of the many underlying trends that support our confidence in achieving our long-term annual average growth rate of 20%.

For several years, we have stressed our goal to advance Acorn to achieve cash flow breakeven and then profitability on a consolidated basis. I am very proud to report that we came very close to achieving that goal in the second quarter despite COVID-related challenges and we are optimistic that we will be able to continue to build on the financial performance of the business to achieve positive cash flow and profitability over the next few quarters.

Of critical value as we approach profitability is the fact that Acorn has a very large net operating loss carry-forward, which would shield future income from income taxes benefiting both net income and cash flow. We believe we are on solid footing for next year, with an expectation that the economy will be more fully reopened and business activity will be – will at least begin to normalize. It's too early to establish specific goals for 2021, but we certainly hope to be in the black from a consolidated earnings and cash flow standpoint in 2021. We believe we have the resources to endure the current COVID induced downturn and we remain confident in the value of our remote monitoring services and the long-term growth potential within a still largely untapped market. Given the opportunities we see, our healthy cash position and my confidence in the OmniMetrix team, I am very enthusiastic about our business and what we can do going forward.

Now, I will turn the call back to Tracy Clifford, our CFO to go over more Q2 financials in more detail. Tracy?

Tracy Clifford
Thank you, Jan. Today, we released our second quarter and year-to-date results in a press release issued this morning and we also filed our 10-Q with the Securities and Exchange Commission yesterday evening. I will review some of the highlights from our GAAP basis results as reported. OmniMetrix's Q2 revenue increased as Jan mentioned approximately 7% over Q2 '19 to $1.5 million, on strength in our largest segment, Power Generation, which grew 19% or $205,000. This increase was partially offset by a decline of $114,000, or 36%, in our smaller Cathodic Protection segment, reflecting the overall challenges that Jan discussed in the energy sector and delayed sales interactions related to COVID-19.

Gross profit grew 13% to $1,022,000 in Q2 '20 versus $901,000 in Q2 '19. The increase in gross profit was principally attributable to a revenue mix that included more monitoring revenue, which has a significantly higher gross margin than hardware. Consequently, gross margin improved to approximately 70% in Q2 '20 versus 65% in Q2 '19.

Operating expenses decreased 5% at OmniMetrix to $823,000 in Q2 '20 versus Q2 '19 primarily due to decreased travel expenses related to COVID-19 restrictions and also a decrease in legal fees. However, we anticipate that the full year 2020 OmniMetrix SG&A costs will increase approximately 15% over 2019 as a result of our fully staffed sales team and continued IT infrastructure investments and other expenditures for growth.

With higher gross profit, coupled with lower quarterly operating costs, OmniMetrix reported a Q2 '20 operating profit of $200,000 versus an operating loss of $40,000 in Q2 '19. At the corporate level, G&A decreased 9% to $222,000 in Q2 '20 from $243,000 in Q2 '19 due to decreased traveling expenses and a reduction in insurance costs, but was flat to Q1 '20, which $223,000. Management does not expect corporate G&A expense to change materially for the full year 2020 other than expenses that maybe required to support growth at OmniMetrix. Net loss attributable to Acorn's shareholders improved to $33,000 or $0.00 per share in Q2 '20 as compared to a net loss of $199,000 or $0.01 per share in Q2 '19. For the first 6 months of 2020, Acorn's net loss attributable to shareholders improved to $316,000 or negative $0.01 per share versus $436,000 or $0.01 per share also in the first 6 months of 2019.

In terms of cash flow, on a consolidated basis, we generated $78,000 from operating activities in the 6 months ended June 30, 2020 as compared to a use of cash of $423,000 in the first half of 2019. The improvement was due to increased receivable collections as well to a reduced net loss. Consolidated cash and cash equivalents were $1,760,000 at June 30th and $1,775,000 on August 9th, including loan proceeds of $462,000 received by Acorn and OmniMetrix in April from the Paycheck Protection Program. Assuming substantially all of the loans are forgiven under the terms of the PPP, we expect to record a related gain later this year.

That concludes my review of the financial results, and now, I would like to turn the call back to the operator, so we can take questions from our investors. Operator?

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-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). At this time, we will pause momentarily to assemble our roster.

Our first question will come from Richard Sosa, who is a Private Investor. Please go ahead.

Richard Sosa
Hi, good morning, Jan and Tracy. How are you?

Jan Loeb
Good morning Richard.

Tracy Clifford
Great. Thanks Richard.

Richard Sosa
Hi. I am great. I just had a few questions. A one great quarter I have been an investor since 2016 and it was great to see it is definitely the best quarter since I have been an investor so congratulations. Just firstly, you did mention that I believe on the last call about manufacturing some of your devices in house. Have you continued with that or how is there any progress?

Jan Loeb
Yes, as of right now, we have continued with that, but as sales have strengthened, we plan to go back to the normal -- a normal structure over time.

Richard Sosa
Okay, and historically, the third and fourth quarter on a cash basis has been materially stronger, do you believe that that could be the case this year? I know this year is very different, and a lot of the drive in the past has been from some of your energy customers, well your larger customers, but do you see that as a possibility this year?

Jan Loeb
It's certainly a possibility. The unknown really is in the CP segment. Typically, in the fourth quarter, the CP segment has been the stronger as some of our customers have budgets to spend and they spend it with us on corrosion protection equipment. It's hard to say with COVID-19, no meetings and oil price and gas price volatility, what will happen in the fourth quarter with their budgets. So, I will take a conservative approach, and that's what we are doing internally, as to the CP segment and the fourth quarter.

Richard Sosa
Okay, and then just in terms of the sale of DSIT, have you received all that cash back and is it in the bank or is there anything left that you'd get back?

Jan Loeb
No, we received all the cash and it is in the bank.

Richard Sosa
Okay, and then just on the PPP money, do we expect that in the third quarter - does that just translate all into sales or how does that work if you can comment?

Tracy Clifford
Certainly. So, the guidance that's out right now, and certainly the SBA is changing. Certain of the regulations on it appears to be a weekly basis, but we will continue to report the proceeds of the loan as a liability until it's partly or wholly forgiven, and we have been completely legally released. I do intend to do an assessment before the filing of the third quarter Q and actually

before the end of the third quarter at 9/30, and see where we are on the '20, as far as the utilization of the proceeds, and if it appears at that time that we have utilized all the proceeds prior to 9/30, then I'm going to go ahead and file for the forgiveness prior to the end of the third quarter, even though we would have a somewhat extended period from that to do so if we have not yet used all the proceeds on the 24-week extended term. At that time, as soon as we are legally released from either all or part of the loan, we would take it in as a gain on extinguishment of the loans, so it will be shown as a gain from loan forgiveness.

Operator
Our next question will come from Peter Rabover with Artko Capital. Please go ahead.

Peter Rabover
Hey, guys. Congratulations on getting to breakeven cash flow and starting to generate cash flow. Hey, I wanted to just kind of follow up on the dynamic of the long-term growth, and as you are introducing new products, how should we think about the growth in terms of the volume versus price versus product mix growth? Is that – I mean, is there kind of like a split that you are thinking about or any color you can give us would be great?

Jan Loeb
I'd say that I don't want to say volume versus price, but I will say that the Smart Annunciator product that we have just introduced is a higher cost product than we have had in the past. So, if the product is successful which we think it will be and hope that it will be, I would think you would see a pickup in hardware sales over time in the PG segment. Smart Annunciator is in the PG segment, so I would see that we should have a pickup there. It has similar margins to our existing hardware product in the PG sector, but just at a significantly higher price point. So, that's one thing that I think you can expect.

Peter Rabover
Is there a higher monitoring revenue component to that or is the [unintelligible]?

Jan Loeb
There is a – no, there is similar monitoring component. So, the Annunciator is a product that incorporates our TG-PRO within the Annunciator, so it will have the similar monitoring revenue, but higher hardware, a higher hardware number.

Peter Rabover
Okay.

Jan Loeb
When we launched our new software product that will flip it a little bit to the other side, that will be more of a SaaS type revenue versus a hardware sale. So, that will flip the monitoring and the SaaS kind of revenue to that side. So, we have different things going on. So it's hard for me to tell you that one is going to be versus another as we have stuff in both categories, but those are some of the trends that you should expect to see over the next few years.

Peter Rabover
Okay, great, and then just a follow-up, I know you had mentioned obviously some difficulty with getting new sales and converting leads into sales because of COVID lockdowns and all that, how has your, I guess, renewal rates with customers have been on the monitoring side, has there been an impact there from the economics like other than the usual disconnect that usually happens, has there been an economic uptick or anything like that or no?

Jan Loeb
No, we have not seen any change in renewal rates or in collection of receivables. As you can see from our cash balances, things have been fairly strong in that area.

Peter Rabover
Okay, great. That's it for me. I will hop off. Thank you.

Jan Loeb
Thank you.

Operator
Out next question will come from Jim McIlree with Bradley Woods. Please go ahead.

Jim McIlree
Thanks a lot. Good morning. I apologize if you went over this in your commentary, but do you have an estimate for how much COVID impacted your hardware sales in the quarter?

Jan Loeb
Jim, hi, good morning. No, we don't have an estimate, but you can tell historically, CP is a growing segment within our company and because we started from a fairly low base, so when in the early years had very strong growth on a percentage basis, last year we had some turnover in the sales people, but -- so you can tell a little bit throughout just looking at the trends, the expected trends in CP versus where we are, you can make an estimate as to what it is, but we don't really look at that.

Jim McIlree
Okay, and did you have, or do you have currently issues on parts to manufacture the units, are there any supply chain issues that you are working through?

Jan Loeb
Currently no. There were at the beginning in March, we had some delays, but today, we have no delays whatsoever.

Jim McIlree
Got it, and I think you said -- I think I heard you say that you think COVID or the grid resiliency is going to have a beneficial impact for you, is that something that's backed up by evidence you have seen so far or is that that more of a, just based on kind of your view of the market?

Jan Loeb
No, it's backed by evidence. If you looked at Generac, which is the largest manufacturer of generators in their second quarter results, they had very strong results in particular in the residential area, so they clearly are seeing an uptick in that, and then if you look, there have been a number of studies done as to the amount of it's obviously a short term study, the amount of electrical usage at homes since the stay-at-home orders were put into place and, the electrical usage is up significantly. I mean, just think about a person at home all day with his computer, going to the refrigerator, having the air conditioning on, just the electrical usage at a home is up substantially. I think I saw one particular study in New York City apartments was up 7%. So, electrical usage is certainly up because of COVID.

Jim McIlree

Yes, no, there is certainly in my house it is, okay.

Jan Loeb
And it's not only just the usage, it's also the need and the importance. So, if you're now working at home, you can't afford to be down for two days. So, I think backup power becomes more important not just because of the usage, but because of the requirement to be up.

Jim McIlree
Yes, fair enough. Okay.

Tracy Clifford
And I think complimentary to that is the is there has been an increase in home improvement costs and investment, more people that are working from home are spending money on their home and there has been some guidance posted out there on the folks are investing a lot more in their homes and their home offices. So, I think we are going to see more generators and alternative backup solutions as a result of that as well.

Jim McIlree
Yes, that's an interesting point, particularly if you're not spending it on restaurants and commuting and parking and things like that.

Tracy Clifford
Exactly.

Jim McIlree
Yes, I appreciate that. Alright, thanks a lot. Good luck with everything.

Operator
Again, if you would like to ask a question, it is star (*) then one (1), star (*) then one (1) to ask a question.

Our next question will come from Jack Mayer, who is a Private Investor. Please go ahead.

Jack Mayer
Hi, Jan. Congratulations on what thank God seems to have been a wonderful quarter. I wondered if you could expand a little bit more on this European initiative. Any particular reason that you started in Italy or it's just a distributor centered in Italy, any particular reason that you started with the air compression, why not PG, why not something else? If you can comment at all on the competitive landscape, there as opposed to the USA anything that you can do to expand on it?

Jan Loeb
We love Italy. It's a great place to visit. The Mel approached us that they had heard about our air compressor solution, and they have done their research and our product was the best in the market, so they approached us about purchasing our product and distributing it within Europe. So, it really wasn't that we were looking for a European strategy. They came to us and they liked, and their business is mainly air compressors, so that's why they chose our air compressor monitor versus our PG monitor, but they are big in Europe and we will see what happens. It's a little bit difficult in Europe for us in terms of monitoring, setting up monitoring, meaning our customer service, which is just a superior customer service to most of our competitors. It's hard to do it in Europe, because of the time differential. So, there are a couple of things we are doing a little

different and that's why I said in my remarks that it will take a little bit of time to develop this completely, but it's a beachhead and I think an interesting one.

Jack Mayer
In terms of what you know about competition in Europe, is there anything that's structurally different than here?

Jan Loeb
Structurally, no.

Jack Mayer
Okay, thanks very much.

Jan Loeb
You're welcome.

Operator
I am showing no further questions at this time. So, this will conclude our Q&A session. At this time, I would like to turn the conference back to Jan Loeb for any closing remarks.

CONCLUSION

Jan Loeb
Thank you. The current environment remains challenging from a growth standpoint, but we are well-positioned from a balance sheet and capital standpoint to navigate the pandemic, and we are well positioned for 2021 assuming business conditions begin to normalize. We will continue to look for growth opportunities in the markets we serve and complementary opportunities and to make investments in product development to meet market demand, where we see it. We would also consider any external acquisition opportunities that might arise as a result of the challenging economic environment. It would be accretive to profitability and to shareholder value.

I just would also like to mention that we are planning to have our Annual Shareholders Meeting on September 14, 2020 and it will be – you can come in-person or a virtual via Zoom and the link will be made available on our website ahead of time and you can certainly contact our Investor Relations team for information and we will put out a press release about that in the coming week. Once again, I thank you for your interest in Acorn. We genuinely appreciate the support of our shareholders and I am happy to speak with investors about the company. Please contact our Investor Relations with any questions or to set up a call with me. Thank you again for your time today. Operator, I believe this concludes our call.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.