

Acorn Energy

Fourth Quarter and Year-End 2018
Conference Call

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CORPORATE PARTICIPANTS

Jan Loeb – *President and Chief Executive Officer*

Tracy Clifford – *Chief Financial Officer*

Walter Czarnecki – *President and CEO of OmniMetrix*

Bill Jones – *Investor Relations*

PRESENTATION

Operator

Good day. Thank you for holding and welcome to Acorn's Fourth Quarter and Year-End 2018 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 Mr. Bill Jones, Investor Relations. Please go ahead.

Bill Jones

Thank you and welcome, everyone, to today's conference call. First, 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 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 to support growth.

Such forward-looking statements are based on management's beliefs as well as assumptions made, which are 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 growth goals in 2019 nor in 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 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 Jan Loeb. Jan?

Jan Loeb

Thank you, Bill, and thank you all for joining us today. I'll give some brief overall remarks, Tracy Clifford, our CFO, will provide financial highlights; and then Walter Czarnecki, CEO of OmniMetrix, will provide color on growth trends and opportunities for OmniMetrix.

First, I want to say that our OmniMetrix operating company achieved its first full year of positive EBITDA and positive cash flow. On the growth side, we tend to look at cash basis sales, which is a revenue plus or minus change in deferred revenue to gauge the underlying growth of the business. We had given guidance for cash basis sales of \$6 million in 2018 versus \$5.1 million in 2017, and through the first three quarters of 2018, we were tracking on this pace. In the fourth quarter of 2018, cash basis sales were relatively flat versus Q4 2017, at \$1.5 million and as a result, we had full-year 2018 cash basis sales of \$5.6 million, an increase of approximately 10% but short of our \$6 million goal.

A number of factors contributed to the shortfall in the fourth quarter, most notably was growing market and economic uncertainty, which seemed to temporarily freeze energy industry expenditures, particularly in December, which is typically our strongest month each year. Despite the fourth quarter weakness, we have seen activity return to more typical levels and remain bullish

on the opportunity for OmniMetrix to continue to grow organically at 20% per year on average. Many of you know that OmniMetrix monitors, manages, and protects high-value industrial assets, primarily standby generators and pipelines, currently utilizing its proprietary remote monitoring and control technology and related services. Our solutions deliver substantial productivity gains and cost reductions to customers versus the labor-intensive alternative, which involves sending personnel to conduct regular physical onsite inspections, often in remote areas.

The OmniMetrix business consists of hardware monitoring equipment sales for new installations, recurring annual monitoring service fees, as well as custom reporting fees. The monitoring side of the business offers a very attractive combination of high gross profit margins and good revenue visibility from recurring service fees. In accordance with GAAP, we record our contract revenue ratably over the estimated life of a service contract, and our hardware revenue over the expected life of the hardware, which is currently three years. Tracy will discuss the financials, but all of Acorn's revenue currently comes from the OmniMetrix business, which remains on a solid growth trajectory with a promising outlook.

Two years ago, OmniMetrix generated an operating loss of \$1.2 million, which improved to a loss of \$783,000 in 2017, and further narrowed to \$116,000 in 2018. With continued growth and cost discipline, OmniMetrix was able to generate a slight operating profit in the second half of 2018, and we expect the business to be both profitable and cash flow positive in 2019. Walter can speak more to the growth opportunities we see for OmniMetrix. Generally speaking, there is increasing awareness by industrial customers of potential productivity increases, lower operating costs, and risk management benefits that can be realized with IoT solutions such as our remote monitoring and control technology.

Early in 2018, we sold our remaining interest in Israel-based DSIT to focus on the OmniMetrix IoT business. In Q3, we recouped approximately \$3,000 in cash from Israel related to withholding taxes on the initial sale of a portion of our DSIT investment in 2016, and we recorded a gain of \$222,000 related to this payment. The cash is being held in our account in Israel until final review by the Israeli taxing authorities of tax returns through 2018, which we expect to be concluded by year-end 2019.

Finally, I want to update investors regarding our efforts in pursuing M&A opportunities that we have mentioned on prior calls. In recent months, we have evaluated several candidates, but we have yet to conclude an acquisition that is accretive and would help us build shareholder value. We will continue to look for accretive opportunities that offer value to our stockholders, but our intent is to only complete a complimentary acquisition that would allow us to scale our business, accelerate our progress towards sustained profitability, and potentially allow the Company to benefit from over \$60 million in operating loss carry forwards. In the meantime, we plan to make investments in OmniMetrix that we believe can facilitate accelerated organic growth and expand our product offerings and customer base.

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

Tracy Clifford

Thank you, Jan, and thanks everyone for joining. Acorn's fourth quarter revenue, which was solely comprised of revenues from our 80%-owned OmniMetrix subsidiary, rose to \$1.3 million, a 17% increase compared to the fourth quarter of 2017. The revenue increase was driven by a 20% increase in our Pipeline segment to \$353,000 versus the fourth quarter of 2017, while revenue from our Standby Generator segment grew 15% to \$958,000 over the fourth quarter of 2017. From a services-versus-hardware perspective, higher margin monitoring revenue grew

20% in the fourth quarter of 2018, while hardware revenues grew 12% versus the same period in 2017.

Gross profit grew 33% to \$810,000 in the fourth quarter of 2018 compared to the fourth quarter of 2017, reflecting both higher revenue and an increase in gross margin to 62% in the fourth quarter of 2018 compared to 54% in the prior-year period. This overall margin increase was principally the result of sales of next-generation monitoring products in our Power Generation segment. The next-generation products provide improved functionality and enhanced design that has enabled us to achieve higher gross margins. OmniMetrix was able to hold operating expenses stable at \$814,000 in the fourth quarter of 2018 compared to \$815,000 in the fourth quarter of '17. While revenue and gross profit is growing faster than operating expenses, OmniMetrix brought its operating loss to near breakeven for a \$4,000 loss in the fourth quarter of 2018 versus an operating loss of \$205,000 in the fourth quarter of '17. This represents \$209,000 of operating profit improvement on \$189,000 of additional revenue, or more than 100% of contribution per additional revenue dollar, and underscores the benefit of incremental growth on business performance.

Now turning to the Acorn consolidated results, Acorn was able to further trim its SG&A by 31% or \$101,000 in the fourth quarter of 2018 to \$230,000 as compared to the prior year period. As a result of improved performance of OmniMetrix and lower corporate overhead, Acorn's consolidated operating loss decreased by more than half to \$234,000 in the fourth quarter of 2018 from \$536,000 in the fourth quarter of '17. Net loss attributable to Acorn's shareholders improved to \$245,000 or \$0.01 per share in the fourth quarter of 2018 compared to \$694,000 or \$0.02 per share in the fourth quarter of 2017.

I won't review the full-year results because they are provided in today's press release other than to point out that we saw similar overall growth trends as in the fourth quarter, with OmniMetrix revenue growing 17% to \$5.1 million in 2018 from \$4.4 million in '17, driven by 44% growth in the Cathodic Protection or Pipeline segment. OmniMetrix also reduced its 2018 operating loss to \$116,000 from \$783,000 in 2017, and was able to generate positive operating profits in the second half of 2018. Looking at Acorn's cash flow in 2018, net cash and cash equivalents increased by \$782,000. The Company used \$2.4 million in operating activities, including the repayment of \$1.9 million of accumulated unpaid operating expenses previously funded by advances from directors and DSIT. Acorn generated \$5.3 million from investing activities on the sale of DSIT and used \$2.1 million in financing activities related to the repayment of \$1.4 million of director loans, \$340,000 of loans from DSIT, and repayment of short-term bank credit of \$313,000.

Importantly, as Jan alluded earlier in the call, based on its recent performance, we expect OmniMetrix to generate positive cash flow in 2019. As of December 31, 2018, Acorn had cash and cash equivalents of \$1.3 million, which included restricted cash of \$290,000, and we did not have any credit line debt outstanding at year end. We have decided to let our previous OmniMetrix accounts receivable factoring agreement expire in accordance with its terms and pay off the balance in its entirety in early November. In March, we reinstated an AR credit line with more favorable terms. This new line provides the Company with access to accounts receivable formula-based financing of the lesser of 75% of eligible accounts receivable or \$1 million, which allows us some flexibility in our cash flow management strategy.

Now, I'd like to turn the call over to Walter Czarnecki to provide some additional color relating to our OmniMetrix business. Walter?

Walter Czarnecki

Thank you, Tracy. Following my comments on the previous earnings call, I shared a key theme of the Electrical Generating Systems Association Conference, which included the fact that the installed base of backup generators is outpacing the pool of generator service technicians. As a result of that trend, we continue to see an increased understanding of and adoption of remote monitoring by generator dealer service organizations. In recent months, we have seen new customers and increased orders stemming directly from that greater level of awareness taking place in the dealer community. Increased awareness and adoption also includes end users in the government, military, and corporate markets, and together with greater dealer awareness continue to be key growth drivers for our Power Generation division.

Within our Cathodic Protection division, increased pressure to reduce operating expenses and improve the productivity of pipeline maintenance remained key growth drivers for our Fortune 500 customers as well as our local utility customers. In addition, the generational labor turnover taking place in the oil and gas market is ushering in a new wave of pipeline integrity managers who embrace remote monitoring and data as a better way to manage and maintain pipelines. To drive and improve productivity, reduce Opex, and a transforming labor force are all key growth drivers for our Cathodic Protection division. During our previous call, I announced the launch of AIRGuard, our remote monitor and control for industrial air compressors. We have continued to ship more products since that announcement, and we continue to learn about this growing market.

Thank you again for joining us today, and I'm happy to answer any questions. I'll now turn the call over to the operator to 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 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.

The first question comes from Richard Sosa. Please go ahead.

Richard Sosa

Hey, good morning, guys. I just had two questions. One, Jan, just on the Acorn cash, can you talk about just the decrease quarter-over-quarter or at least from the third quarter to fourth quarter?

Jan Loeb

At the Acorn level, it's just the normal operating costs that we have. We also, in the quarter, paid off some payables that we had. And, that's really about the only differences in the quarter.

Richard Sosa

Okay. And, then this is a question for either Jan or Walter, just on the CP segment. Obviously November-December were tough for everyone, and I do understand that this expense for a lot of MLP companies might be the last one on the totem pole. So, just curious, you alluded to it somewhat, that you saw the business returning in the first quarter, but if you can talk more about that and whether or not you feel that you can get some of those sales back in the first few quarters?

Jan Loeb

I'll let Walter...

Walter Czarnecki

Yes. Good morning, Richard. Thanks for the question. Yes, we absolutely do, and we saw this in 2013 when oil and gas prices went up and there was some uncertainty and saw budgets being held temporarily. That did not change the long-term attraction to remote monitoring in IoT for these businesses. It merely just shifted the timing a bit, and that is what we are seeing and expect to see happening here. We've already received orders and purchases in 2019 that are confirming that trend, and we'll continue to see this in the year -- quarters and years ahead in terms of brief shifts in timing when there is uncertainty that hits the oil and gas market, but in the long term, we know because our customers have told us that they see value in it and they are committed to this kind of technology.

Richard Sosa

And, have you received good reception on the Hero 2? I know that's an upgrade, correct, from your last product?

Walter Czarnecki

We have. It's an improvement on a number of different levels with the product and with the customer experience, and yes, we have received lot of positive reviews so far, and more units are being installed and deployed in recent weeks and in the weeks to come. And, so it's been very positive so far.

Richard Sosa

All right, great. Good to hear. Thank you.

Operator

Again, if you have a question please press star (*) then one (1).

Bill Jones

We do have a question coming from online.

Operator

Okay.

Bill Jones

The question is, you mentioned the compressor product, is there other remote monitoring opportunities that you see potentially for Acorn or OmniMetrix?

Jan Loeb

Walter?

Walter Czarnecki

I can take this call or this question rather, absolutely, and as we have discussed on previous calls, the power generation product line, it's important to note, is an industrial engine monitor, and while many customers and groups know of us as a generator monitoring company, that is just one segment that we chose several years ago based on the size and growth of the generator market. It really applies to any industrial engine application, so engines, pumps, other industrial applications and motors. And, so we have chosen the compressor market again because of its size and growth, and we have seen good success there, and there are other areas both in

engines, in batteries, and other parts of the industrial landscape that we feel have opportunity and have growth. And, so we're going to be continuing to deploy that in the quarters and years ahead.

Bill Jones

Okay. And, as a follow-up to that, when you sold DSIT, there was talk of a technology sonar related that we might have rights or right of first refusal. Is there anything more you could say or any developments in that area?

Jan Loeb

Yes. We had the right of first refusal for some fiber optic technology as it relates to pipelines, and that is still the case. The product was not totally developed yet by DSIT, and they are continuing to develop it. They've actually placed a pilot unit in the field and are waiting to get results from that. So, I think as that product develops, we'll see where it goes here in United States. But, that still is, I would say, at least a year away.

Bill Jones

And that's United States only. Do you see any international opportunities outside of that?

Jan Loeb

Our right of first refusal is only in the United States.

Bill Jones

But generally speaking, for any other products, is there any international opportunities?

Walter Czarnecki

For our other products in remote monitoring and control, yes, we have rest-of-world opportunities.

Bill Jones

Thank you.

Operator

Again, if you have a question, please press star (*) then one (1).

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. Since I became CEO in 2016, we have narrowed and simplified our strategy to focus on the IoT sector, and we improved our balance sheet by disposing of other assets. We have also reduced our cost structure and lowered our breakeven level. We feel we are well-positioned for our next phase. From here, top line growth and operating leverage should continue to drive bottom line performance to the benefit of shareholders. If possible, we would like to supplement our growth at OmniMetrix with suitable and similar acquisitions but only potentially accretive targets that make sense for our shareholders.

I want to thank you for your interest in Acorn. I view Acorn as an attractive platform for building value for shareholders. I am grateful for the support of our investors, and I am always pleased to speak with anyone who has questions about the Company or about our direction. Please contact

our Investor Relations team to set up a call with me or to answer any questions. Thank you again for your time today. And with that, Operator, we can end this call.

Operator

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