Acorn Energy, Inc.

Q4 2019 Earnings Conference Call

Thursday, March 26, 2020, 11:00 A.M. Eastern

CORPORATE PARTICIPANTS

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

Jan Loeb – *Chief Executive Officer Acorn and Chief Executive Officer OmniMetrix*

PRESENTATION

Operator
Thank you for holding, and welcome to Acorn Energy’s Fourth 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 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 may be 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 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 2020, nor 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 yesterday.

Now, with that, I will hand the call over to Jan Loeb, CEO of Acorn and Acting CEO of OmniMetrix. Jan?

Jan Loeb
Thank you, Tracy, and good morning to those joining our call today. Before I review our operating performance in 2019, I would like to address our business’ position to weather the unprecedented environment created by the COVID-19 pandemic. While it is very difficult to predict the near-term impact of the pandemic on our operating results, I do want to point out that Acorn has built a strong balance sheet, a strong cash position of $1.6 million over the past few years, and we believe we are well positioned to weather the brunt of the business impact over the next several months.

I would also like to remind investors of the unique and recurring nature of our monitoring business and its cash flows with historic renewal rates of 90% plus, gross profit margins of approximately 83%. While certainly our business development efforts will be substantially impacted in the near term, it is important to note that the value of our remote monitoring and control services business becomes even more evident in an environment where personnel and field activities are being disrupted by travel restrictions, illness or other factors. For this reason, we continue to believe that the market adoption of IoT technology broadly will return to its long-term growth trend as the pandemic subsides. We are also taking active steps to adjust our cost structure and suspend certain activity to minimize current expenses and to shore up our ability to endure this challenging environment and to leverage any market disruption that may occur.

Like all of you, we are working to understand the depth and breadth of the impact of the COVID-19 pandemic and therefore it is really not possible to comment with any greater specificity at this time.

Let us now turn to our review of Acorn and OmniMetrix 2019 performance, following which we will open the call to your questions. In the fourth quarter and full year 2019, OmniMetrix extended its record of revenue growth, improved gross margin and achieved a third consecutive quarter of positive operating profit. OmniMetrix Q4 2019 revenue rose 7% to $1.4 million and gross margin improved to 67.6% versus 61.8% in Q4 2018. For the full year 2019, revenue grew 8% to $5.5 million, gross margin improved to 65.4% from 61.4% and gross profit grew 17%. This performance allowed OmniMetrix to realize an operating profit in 2019 versus a loss in 2018. On a consolidated basis, Acorn was able to cut its operating loss by more than half to approximately $700,000 versus $1.4 million in 2018. We are proud of the discipline and hard work of our team to achieve these gains.

As many of you know, we use cash basis sales as a performance tracking measure to supplement revenue and give us another view of our growth in a given period. Pursuant to GAAP, we recognize revenue from our hardware sales over three years, and typically over one year for our monitoring contracts, even though the cash is generally received upfront. Cash basis sales, therefore, provides visibility on the level of business that was completed in a period and therefore window on relative growth performance. Cash sales for 2019 were $6 million compared to $5.6 million in 2018, an increase of 7%.

Our Power Generation or PG segment sales which relate to monitoring standby generators, grew by 13% on a cash basis in 2019 versus 2018. In our smaller Cathodic Protection or CP segment which focuses on monitoring and control of the electric current running on gas pipelines, sales on a cash basis declined by 21% due to the impact of turnover in our sales staff and not being fully staffed throughout the year. Sales staff turnover was a combination of staff departures and changes initiated by management to strengthen our team.

In Q3, we completed several new sales hires and earlier this year we hired a new Director of Sales, Daniel Hess. Dan’s extensive and very relevant IoT sales experience including developing new products and multimillion-dollar accounts was reviewed in yesterday's press release. Notably, Dan has over 25 years of experience successfully executing growth initiatives within the telecom, wireless, analytics and IoT spaces. Most recently, with Sierra Wireless and its Numerex subsidiary. We believe Dan has the right experience and ability to drive sales of new products and to address new market opportunities for OmniMetrix. We are now fully staffed and believe we now have the potential to increase our CP segment sales to historical and projected growth rates in future quarters as the pandemic subsides.

Despite the disruption in our Cathodic Protection sales team, our new team members are making considerable progress building a solid pipeline of customer trials that we hope to convert to deployments later in 2020 and thereafter. Reflecting the team's progress, we currently have 4 times the number of customers trials in progress than we had at this time last year.

Moving to Power Generation, historically our business has been favorably impacted by disasters and emergencies, such as hurricanes and storms that disrupt power systems and raise awareness of the importance and value of remote generator monitoring. For example, we provide remote generator monitoring for thousands of hospitals and other critical healthcare facilities across North America and we stand ready to provide support should additional remote monitoring services be required to support the healthcare response for the current pandemic.

Turning back to our improvements in gross margins throughout 2019, I want to underscore that this achievement is not only the result of a favorable product mix of higher margin monitoring revenue, but also due to deliberate initiatives that we have pursued in recent years to develop and bring to market innovative new hardware and software offerings that deliver enhanced functionality, as well as more efficient lower cost designs that support our margin growth profile.

Next-generation products that have supported gross margin improvements include our Hero 2 Rectifier Monitors and our AIRGuard industrial air compressor monitors. We also are about to launch an innovative new enunciator product that provides status updates on critical electrical systems and we have a new software product that we expect to announce in the second half of this year.

Now turning the call back to Tracy Clifford, our CFO, to go over the financial highlights. Tracy?

Tracy Clifford
Thanks, Jan. As mentioned by Jan at the beginning of the call, OmniMetrix's Q4 '19 revenue increased 7% to $1.4 million from $1.3 million in Q4 '18 driven by strength in our largest segment Power Generation. Full year 2019 revenue grew 8% to $5.5 million in 2019 from $5.1 million in 2018 with Power Generation growing 17% to $4.3 million. This increase was partially offset by a decline of $223,000 or 16% in our Cathodic Protection segment to $1.2 million in 2019, reflecting a decrease in hardware sales as a result of the sales staff turnover that Jan previously discussed.

As Jan also noted, our sales team has been fully staffed since the beginning of 2020. Gross profit grew 15% to $3.6 million in 2019 versus $3.1 million in 2018, significantly outpacing revenue growth. The increase in gross profit was attributable to revenue growth, increased hardware gross margin and a better mix of monitoring revenue, which yields higher gross margin in hardware. As a result, gross margin improved to 65.4% in 2019 versus 61.4% in 2018. Q4 '19 gross margin improved to 67.6% versus 61.8% in Q4 '18 reflecting similar dynamics.

OmniMetrix total operating expenses increased 4% to $3.4 million in 2019 versus $3.3 million in 2018. We will closely manage further spending increases focused on driving sales as economic and market circumstances make it prudent to invest in the expansion of our sales team and our IT systems to support long-term growth. With revenue and gross profit growth outpacing expenses, OmniMetrix's reported a 2019 operating profit of a $177,000 versus an operating loss of $146,000 in 2018. OmniMetrix also generated an operating profit of $83,000 in Q4 '19 versus an operating loss of $34,000 in Q4 '18.

At the corporate level, Acorn reduced its G&A by 30% to $876,000 in 2019 from $1.3 million in 2018, reflecting the range of cost reductions related to personnel costs, board fees and other public company costs. Lower corporate overhead combined with growth at OmniMetrix allowed Acorn's consolidated operating loss to be cut approximately in half to $699,000 in 2019 from $1.4 million in 2018. Net loss attributable to Acorn's shareholders was $618,000 or $0.02 per share in 2019 as compared to $2 million or $0.07 per share in 2018. The prior year period included a loss of $0.02 per share related to the sale of DSIT. In Q4 '19 net loss attributable to Acorn's shareholders were $61,000 or flat $0.00 per share versus a net loss of $245,000 or $0.01 per share in Q4 '18, which included a gain of $222,000 or $0.01 per share related to the DSIT transaction.

Looking at cash flow on a consolidated basis, Acorn reduced its net cash used in operating activities to $1.2 million in 2018 from $2.4 million in – I am sorry $1.2 million in 2019 from $2.4 million in 2018. Of this $1.2 million, approximately $404,000 related to OmniMetrix and including $323,000 used to retire loan from a former director with the remainder related to Acorn. On a consolidated basis, Acorn had cash and cash equivalents of approximately $1.2 million.

As of March 20th, on a consolidated basis, Acorn had cash and cash equivalents of approximately $1.6 million and outstanding balance on our operating credit line of $369,000 and $115,000 available to borrow.

That concludes my overview of results, and now let me pass the call back to Jan.

Jan Loeb
Thank, again, Tracy. Though the current environment is very challenging, we are actively managing our resources and costs to navigate the COVID-19 pandemic. As we see business conditions begin to normalize, we will resume prudent investments and product development, sales resources and IT support to profitable growth. We will also consider any shareholder value enhancing opportunities including tuck-in acquisitions on an opportunistic basis. Perhaps there may also be opportunities that occur as a result of this challenging environment.

With a solid balance sheet, we will continue to be disciplined and patient regarding any external opportunities.

For OmniMetrix, we continue to have a normalized top-line growth goal of 20% per year on average. From a profitability perspective, we reduced consolidated net operating loss by approximately 50% in 2019, and excluding any impact from COVID-19, we had expected to be on a cash flow breakeven run-rate by this summer. It is too early to assess the impact of COVID-19 at this point, where achieving breakeven is important from a shareholder value perspective especially considering our large NOLs, which would shield future income from income taxes. We feel we have this financial resource available to reach these financial goals, although the timing is less certain in the current environment.

We thank you for your support in this journey, and with that, I would like to turn the call back to the operator, so we can take questions from our investors.

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 comes from Richard Sosa, Private Investor. Please go ahead.

Richard Sosa
Hey Jan, how are you doing? It’s Richard.

Jan Loeb
Good morning Richard.

Richard Sosa
Good morning. I just had a few questions. Just on the monitor -- I am always perplexed, I saw monitoring is up 22%. Can you just walk me through how that is up so much with hardware being down year-over-year? I mean it's a good thing obviously, but I was just curious how that works.

Jan Loeb
So, monitoring revenue reflects the growth that we've had in previous years versus new sales is what we did in a particular year. So, since over the last few years, we have had good growth in monitoring -- in product sales. Monitoring sales were up stronger than new sales. In addition, monitoring is cumulative. So, every year presumably, even if new sales are not growing, the fact that we are making new sales add to our monitoring revenue. So, monitoring reflects a cumulative number of units that we have in the field, and therefore, its number can grow even though our new sales growth number is not growing as rapidly.

Richard Sosa
Got it. Got it.

Tracy Clifford
And I can just add to that, Richard, for some additional clarity. We actually start amortizing the revenue in when a unit is installed. So, a dealer could purchase a large number of units to put in inventory and install them on varying dates moving forward. So, any inventory that would have been in hardware sales at the end of '18 that were connected in '19, we’d start seeing that. So, I thought that might be helpful to understand.

Richard Sosa
Okay, and then just two -- kind of two questions off of this. I saw in your press release and the 10-K, you’re just kind of talking about any potential disruption in supply chain on the hardware side. How much inventory do you have and where is it sourced from? Is it all from America or is it from all over the place?

Jan Loeb
So, at year-end our inventory was approximately $290,000. All our products are assembled in the United States. Some of our circuit boards come from China, but everything is assembled here in the U.S. I would say in China -- at the height of COVID-19 in China, it was hard to get circuit boards. We most probably had a three-week back -- delay in getting circuit boards. Today their delay is three days. So, we have not -- as of right now, we have not had any disruption in product flow.

Richard Sosa
And is still assembling okay in America?

Jan Loeb
Yes.

Richard Sosa
Okay, and then on the monitoring side, obviously, as you know the reason why I like this company so much is its -- the recurring revenue, which has a high value -- is really high value in the sense that people just can't cancel. What does it have to take for people to stop paying? And ultimately, if they stop paying, they don't get monitored. So, one, have you seen any of that happening more so over the last few weeks or what would have to happen?

Jan Loeb
So, we have not seen it happen yet. It is certainly something that we concern ourselves with, but if you think about it logically, monitoring is a profit center for our customers. So, we sell our monitors to the dealers, the dealers mark up the monitoring and they sell it to their end customer. So, we're a profit center for the dealer, and I think that's one thing to recognize. Second is, the customer, whether it is a residential customer or a commercial and industrial customer, if you’re spending $15,000 to buy a generator for standby power or more, you need it or you’re a well-heeled individual. So the typical customer of our customer, of our dealers are usually people who can well afford to buy a generator and therefore well afford to spend anywhere between $10 and $25 with their commercial industrial customer on the monitoring, and thirdly, most of our dealers sell yearly monitoring packages. So, they have already sold a yearly monitoring package to their customer and if we don't get paid, our policy is we turn off the monitor. It would put the dealer in a sticky situation where his customer has already paid for the monitoring and then suddenly his monitor goes off. So for those three reasons, logically, we should continue to get paid on our monthly monitoring business, which as you properly said is very profitable and very key to our business, but I don't know that necessarily logic is the right way to look at it in this environment, but so far, we have not seen anybody not pay us.

Richard Sosa
Correct, and then just -- and you might not be able to answer this, but since most of your business comes from these generator dealers, how are they doing it? Do they have good balance sheet? Are they working right now? Are they installing? Are they even able to put in generators right now or is that halted as well?

Jan Loeb
You're right. I don't really know the answer. All I can tell you is we still do get new orders. So, at nowhere near the pace that we got in January and February, but we are still getting orders. So, I have to assume that they are still working, but clearly, I don't know their own financial position.

Richard Sosa
Okay. That is, that is all I got.

Jan Loeb
Thank you.

Operator
Our next question will come from Sam Schecter, who is a private investor. Please go ahead.

Sam Schecter
Hey Jan. Thanks for taking my call. I got two questions. Number one, are you in an active search for a new CEO, somebody more permanent?

Jan Loeb
Right now, we are not actively searching.

Sam Schecter
Okay. My second question was, what compensation package do you offer your sales people?

Jan Loeb
We offer a combination of a base salary …

Sam Schecter
I will tell you I'm trying to figure out – I am trying to figure out how you can bring a guy in with 25 years of sales experience with revenues where they are. So, I'm assuming you're trying to ramp this up?

Jan Loeb
Correct, and again, he is Director of Sales, so not only do we expect, so to speak, that he himself is helpful in bringing in sales, but more importantly there is an exponential impact because he being a senior as he is, and having led sales teams in the past, will help increase the sales of all six of our other sales people. So, there will be an exponential impact.

Sam Schecter
Is this the only position currently?

Jan Loeb
Yes.

Sam Schecter
Okay. Thank you very much.

Jan Loeb
Thank you.

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

I am showing no further questions at this time. So now 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 their interest in Acorn. We appreciate the support of our investors. I am always happy to speak with existing or prospective investors, who may have questions or concerns about the company and our strategic direction. Please reach out to our Investor Relations team with questions or to set up a call with me. Thank you again for your time today. Everybody should stay safe. Operator, I believe that should conclude this call.

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