Acorn Energy

Q1 2020 Conference Call

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CORPORATE PARTICIPANTS

Jan Loeb - *Chief Executive Officer*

Tracy Clifford - *Chief Financial Officer*

Operator
Good day, everyone. Thank you for holding and welcome to Acorn Energy's First Quarter 2020 Conference Call. All participants are in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask any question, you may press "*", then "1" on your touch--telephone keypad. To withdraw your question, please press "*", then "2." Please note this event is being recorded.

I would now like to turn the conference over to Ms. 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 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, and this factors on Acorn's Form 10-K as filed with the Securities and Exchange Commission.

I'll now hand the call over the Jan Loeb, CEO of Acorn.

Jan Loeb
Thank you, Tracy, and good morning to those joining our call. To start off, I would like to discuss the COVID-19 situation and how we are addressing it as a company, and why we think we're well-positioned to get to the other side of this pandemic in an even stronger position. As you know, we provide monitoring and control services for industrial equipment, including backup generators for government and healthcare facilities. As a result, OmniMetrix operations have been classified essential by the state of Georgia, enabling us to continue to operate throughout the pandemic.

Though we have moved to reduce onsite work as much as possible, while instituting a variety of protections designed to keep our team safe. For purposes of social distancing, we reduced the number of on-premises management employees at our Georgia facility to an average of 5 people versus approximately 20 normally on premises. The remaining team members are able to work from home and have been doing so successfully. The state of Georgia has reopened and we now expect to have employees return to the office starting this coming Monday, May 18th. Of course, we will adhere to guidelines issued by the Centers for Disease Control regarding social distancing, handwashing, and wearing a facemask as appropriate.

Though we started the year with encouraging growth, we finished the quarter only up 1% on a GAAP basis, as COVID-19 responses began to significantly impact our new equipment sales due to travel and business activities restrictions. So far, in Q2, we're seeing only about a 9% decline in sales volume, principally related to a decrease in new hardware sales, highlighting the strength and recurring nature of our core monitoring service revenue. It remains very hard to predict how the COVID-19 pandemic will ultimately impact business and consumer decision making and investments in remote monitoring, as well as impact on the pace of our sales effort.

On the plus side, however, remote monitoring is an ideal solution for managing industrial equipment more cost effectively, while at the same time substantially reducing or eliminating the personnel and travel required to manage disparate assets over wide geographies. Clearly, this benefit is gaining great appreciation, given social distancing and other mandated personal safety requirements related to the pandemic.

Financially, we have a strong vantagepoint from which to navigate this environment with $1.9 million in cash as of May 10th, including loan proceeds received by Acorn and OmniMetrix in Q2 2020, under the CARES Act, to support companies through the pandemic. Given the opportunities we see, our financial position, and management's confidence in our team members, we have not laid off any employees in relation to COVID-19 and we do not expect to do so.

We are also implementing programs to lower costs and maximize efficiency. One example is the decision to take certain aspects of our hardware assembly work, which were previously outsourced, and bring them back inhouse. This will reduce overall costs and give us more control over quality, production timelines, and inventory. We believe we have the resources to endure the expected downturn and remain confident in the efficiency and value or our remote monitoring services and their long-term growth potential within a still largely untapped market.

Throughout this process, we will continue to actively seek opportunities to streamline our core structure and to make prudent investments in product development and sales and marketing to ensure OmniMetrix's leadership in the industry.

Let me now briefly touch on our Q1 2020 results and, following that, I will--following that, I will let Tracy provide more specifics on our financial performance, and then we will open the call to your questions. I would like to highlight a few notable items from Q1 performance, beginning with our gross margins. We continue to achieve solid gross margins with our Q1 2020 gross margin rising to 69% versus 62% in Q1 2019. An increase in gross margins primarily reflects a favorable of mix of higher margin monitoring revenue compared to product sales.

I also wanted to point out cash-basis sales--a performance tracking measure we use to supplement our reported revenue and revenue growth trends. We recognize revenue from hardware sales pursuant to GAAP over a 3-year period and recognize revenues from monitoring contracts over the period of service typically one year, while generally receiving cash up front, creating a disconnect between cash received and GAAP revenue recorded in a period. As a result, we also track cash sales to provide more visibility on the volume of business closed during the period which will be recognized as revenue over time and to compare actual cash sales growth to prior periods. Q1 2020 cash basis sales were $1.301 million as compared to $1.317 million in Q1 2019, a decrease of 1%. This is notable because, despite the impacts of COVID-19, we were able to hold cash sales essentially flat during the quarter.

Looking at the performance of our segments--in our power generation segment--the monitoring of standby generators for commercial and residential accounts--our cash-basis sales were flat on a cash basis in Q1 2020 versus Q1 2019. In our small cathodic protection segment, which focuses on the monitoring control of electric current running on gas pipelines, cash basis sales declined by 5% as our sales team gained traction and we deal with the initial restrictive impacts related to COVID-19. In this segment, where clients are principally larger corporations, typical sales interactions with prospective customers have been tabled due to social distancing and other restrictive policies in place currently. Bear in mind that our new expanded and experienced sales team have made considerable progress building a solid pipeline of customer trials prior to the COVID-19 disruption. We have about two times the number of customer trials in the field than we had at this time last year, though the sales cycle in this segment can be 12 to 18 months.

Of course, the pandemic made delay--may delay or reduce our progress in converting trials into formal agreements. We still hope to convert most of those trials to deployments over time. Of course, there are some customer budget challenges in the energy sector related to pricing, volatility, supply and demand disparities, and COVID-19 impacts. We see expanding opportunities for our AIRGuard industrial air compressor monitors, which we believe have a market opportunity comparable to that of our generator market, and there are cross-selling opportunities with existing industrial customers.

We are also in the process of launching an innovative new smart enunciator product this month that provides status updates on critical electric systems. We have a new software product that we expect to announce in the second half of this year. So, despite challenges in the near term, we believe there are plenty of market opportunities. Historically, new monitoring sales have been favorable impacted by natural disasters and emergencies such as hurricanes and storms that disrupt power systems and highlight the importance and value of remote generator monitoring. The COVID-19 pandemic has the potential to be similar.

As more people today are working from home across the country, given this change of work location, ensuring reliable electricity access for home offices is more important than ever and could stimulate demand for backup power generation and our monitoring solutions. Longer term, excluding the impact of COVID-19, we continue to have confidence in our annual growth goal of 20%. We also have a goal of reaching consolidated cashflow break even, which prior to COVID-19 outbreak, we had expected to achieve by mid-2020. This is clearly an important goal for our company, especially considering our large NOL position, which would shield future income from income taxes.

We still believe we have the financial resources available to reach these goals, although the timing is uncertain in the current environment. We hope to have more visibility next quarter, as regions of the country start to reopen, and business normalizes. Now, I'll turn to call back to Tracy Clifford, our CFO, to go over more Q1 financial details.

Tracy Clifford
Thank you, Jan. I want to start by clarifying that while Jan has discussed cash-basis sales, I'll be discussing GAAP-basis performance as presented in our filed financial statements. OmniMetrix's Q1 revenue was essentially flat, increasing approximately 1% over Q1 '19 due to strength in our largest segment, power generation, which grew 11% or $109,000. This increase was offset by a decline of $102,000 or 31% in our cathodic protection segment to $229,000 in Q1, reflecting a decrease in sales and challenges in this segment and the energy sector as previously discussed.

Gross profit grew 12% to $922,000 in Q1 ’20 versus $821,000 in Q1 ’19, significantly outpacing revenue growth. The increase in gross profit was principally attributable to a revenue mix that included more monitoring revenue, which is a significantly higher gross margin that hardware. Also, the prior year period included a $30,000 dollar cost of sales adjustment related to obsolete inventory. As a result, realized gross margin improved to 69% in Q1 ’20 versus 62% in Q1 ’19, or 64% after you adjust for the inventory charge in ’19.

OmniMetrix’s total operating expenses increased 11% to $973,000 in Q1 ’20 versus $879,000 in Q1 ’19, mainly due to planned increases in personnel costs, IT software and infrastructure expenses, travel expenses, and payment processing charges. We anticipate that for the full year of 2020, SG&A costs will increase approximately 15% over the 2019 full-year cost, as a result of a fully staffed sales team and continued IT infrastructure investments.

We will closely manage any further spending increases, focusing on driving sales as economic and market circumstances make it prudent to invest to support our long-term growth. With higher gross profits offset by higher operating costs, OmniMetrix reported a first quarter of ’20 operating loss of $51,000 versus an operating loss of $58,000 in Q1 ’19. At the corporate level, G&A increased 7% to $223,000 in Q1 ’20 from $209,000 in Q1 ’19, reflecting an increase in officer compensation, travel--and travel expenses offset by reduced insurance expense.

Management does not expect corporate G&A expense to increase materially for the full year 2020, other than expenses that might be required to support growth at OmniMetrix. Net loss, attributable to Acorn’s shareholders, was $283,000 or a penny per share in Q1 ’20 versus a net loss of $237,000 or a penny per share in Q1 ’19.

Turning to cash flow on a consolidated basis, cash generated from operating activities was $242,000 in Q1 ’20 versus cash used in operating activities of $325,000 in Q1 ’19, mainly due to the increased accounts receivable collections in first quarter ’20. Consolidated cash and cash equivalents were approximately $1.4 million as of quarter end. As of May 10th, our consolidated cash and cash equivalents are $1.9 million, which includes the loan proceeds of $461,000 received by Acorn and OmniMetrix in April, under the CARES Act.

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

Operator
At this time we will now begin the question and answer session. To ask a question, you may press “*”, then “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 “*”, then “2.” At this time, we will pause momentarily to assemble our roster.

And our first question comes from Peter Rabover of Artko Capital. Peter, please proceed.

Peter Rabover
Hey, Jan. Hey. I wanted to focus some of my questions on your monitoring revenue piece. That’s obviously growing well and steady and I guess I’m just curious if you could add a little bit more detail on how many subscriptions you--maybe volume of subscriptions and average price, and what’s been the driving dynamic. And then, I guess in that same vein--I don’t know if that helps or not--but maybe a way to think even though hardware sales are volatile, clearly each dollar of hardware sales adds something to the--monitoring revenue segment ‘cause it sounds

like you're outpacing your disconnect rate and may be a good way for us to think about how much does each dollar of hardware add to the monitoring revenue. If you could give us any color, I'd really appreciate it.

Jan Loeb
Okay. Good morning, Peter. Thank you for your question and your support of the company. The--our monthly--because that's the way we look at it--our monthly monitoring revenue ranges anywhere from approximately $10 dollars to $30 dollars a month, depending if you are a residential owner--again, we don't sell directly to the owner, but we sell to the dealer who sells to the residential owner--to if you're a commercial and industrial user of our monitoring system. That's the range--$10 to $30 dollars a month. You're correct that for every piece of hardware we sell, we typically sell it with a one-year contract and that--and we have 90+ percent renewal rate because once the monitor is embedded in the generator, there's really no reason for anybody to change the monitor to go to somebody else 'cause that costs more than over a year's worth of monitoring the difference. It's just not worth it. The renewal rate in the business is quite good.

There should always be growth in monitoring. There are some disconnects. You--typically our disconnects are not because somebody doesn't want service, but somebody moves and--from house A to house B and the new owner doesn't even know that there's a monitor sitting inside the generator, so we usually have some disconnects. We have some disconnects for people who don't pay, but generally--as I said--we have an--over 90% renewal rate on our monitoring. Does that answer most of your question?

Peter Rabover
Yeah. I guess just more of the way to think about what's--I guess maybe more statistics. What do you think the average life of your monitoring revenue customer--as I know you said 90% plus renewals and you've been around for a while, so I would assume those lives are in years instead of months. And then…

Jan Loeb
Yes, it's--the average person is well over 5 years. It's--as I said--the stickiness of the business is quite good and it's--as you--and you can tell the margins are quite good and--on the monitoring side--and we view that as really the core of our business and what makes our business so valuable. As you can see during this period of time, we really haven't had a decrease that you would expect. Like most companies.

Peter Rabover
And--right. And then, maybe from the competitive/sales position, I assume your gross expenses direct--cost of goods sold on the monitoring stuff is the commission that you pay to your dealers? Is that the way to think about it?

Jan Loeb
Our usually our commission to pay to dealers is a net price. That doesn't come up as expense. Our main expense is data. All our monitors have cellular radios built in and we are constantly monitoring that unit, so we have data costs. Our major expense in the monitoring, once they're put in, is data cost.

Peter Rabover
Does the dealer receive any piece of the monitoring revenue that you collect?

Jan Loeb
Yes.

Peter Rabover
The reason I'm asking that--so I'm trying to get at--and I--because you sell primarily through the dealer network and your competitors are OEMs that have their own monitoring hardware and software built in, so I'm just curious whether that's a nice selling point that you're incentivizing your dealers that they--even after they sell the product, they get to receive a piece of the revenue from you relative to your competitors. Your competitors offer those sort of incentives to their dealers or not and I guess I'm just trying to think of it like that's a positive revenue generator for your dealers that other--that their other suppliers do not provide them.

Jan Loeb
Yes. I would say is that we definitely have a very good incentive to our dealers and our dealers very much like us and dealers have been with us for many years. And some of the selling advantages that we have is that--I think that it--that some of the OEMs do provide incentives as well, so I don't even--I don't know the incentives themselves are the number one s--differentiator between us and our competitors. I think the number one differentiator is that our dealers want to control the end customer, and they don't want the OEMs to be in touch with their end customer because the dealers want to sell them service and parts and maintenance, which is the most profitable part of the dealer's business. If the OEM gets inside with the customer, the OEM can start selling parts directly to the customer.

I think that's the number one reason why people like us relative to the OEM. We also have a much better product. Our product is more data rich, which some dealers find important, other dealers don't find it that important, but I think that would be the second reason why dealers really like us. We do have a premium product in the marketplace.

Peter Rabover
Okay. And then maybe one last question. I--we've had a couple of quarters since the PG&E debacle in California and I know it's kind of a mixed bag with the COVID stuff, but have you seen any noticeable uptake or result of that that you can comment on? And, if not, that's not a problem, but just curious.

Jan Loeb
Right. We have not yet seen that and, typically, I would not expect to see it. But firstly, the dealers have to get set up. It really wasn't--it was not--there were not that many dealers out there 'cause it wasn't such a big market. The dealers have to get set up first, then they have to sell generators, then they sell monitoring--kind of in that order so to speak. We have not seen it yet, but it is something that I anticipate seeing coming out of COVID-19.

Peter Rabover
Okay. I--sorry--and I guess just like maybe one last question, but h--this is--pardon my ignorance on this, but have you--is there any way to participate in the battery storage business for you guys as more and more storage costs lower and more and more people have solar or battery packs installed their house that--to monitor those sort of things?

Jan Loeb
There are ways for us to enter that market and we are definitely on top of it.

Peter Rabover
Okay. Great. Thank you so much, Jan, and keep up the good work. Thanks.

Jan Loeb
Thank you.

Operator
And as a reminder, if you have a question, please press "*" then "1." Our question comes--our next question comes from Richard Sosa [SP] of inv--private investor. Richard, please proceed.

Richard Sosa
Hi, Jan. Just had one quick question on the hardware. You had mentioned that you were planning on taking some of the manufacturing back inhouse. I just wanted--if you can maybe go into when you could make some of these products inhouse and why you changed and why you're looking to change back.

Jan Loeb
It's a question of using our team efficiently and in this environment. I've made a commitment to our employees that we really do not want to fire anybody and, so, we want to use our employees efficiently. Rather than have some product produced by an outside vendor, if we can do it inhouse during this period of time where sales are not that robust, why not produce it inhouse? This way we can keep our employees working efficiently and we have, as I said, better control over the quality and the inventory during this period of time. I do envision, post COVID, that sales--that new equipment sales pick up--that we would then allow our outside vendor to do the assembly and we would move it back out. But right now, why pay them if we can keep the cost inhouse?

Richard Sosa
Okay. That's something that's pretty easy to do. I'm assuming you had been making them prior. That wasn't that long ago?

Jan Loeb
Correct.

Richard Sosa
Okay. And I guess that's it. Thank you.

Jan Loeb
And, by the way--and, Richard, we do have the ability, not just from a personnel standpoint, but from a facility standpoint, to do it.

Richard Sosa
Right. Right. And you--last quarter, during the March call, you had mentioned that one of the risks was that you would be unable to get some parts, possibly. Has that risk gone away or do you--.

Jan Loeb
Yes.

Richard Sosa
Obviously, you could still worry about it, but it's probably not too big of a worry now, as things seem to be getting back to normal?

Jan Loeb
Correct. We have not had any problem right now with that.

Richard Sosa
Okay. Thank you.

Jan Loeb
Thank you.

Operator
As a final reminder, if you have a question, please press "*" then "1."

At this time, we have no further questions. I would now like to turn the conference back over to Jan Loeb for any closing remarks.

Jan Loeb
Obviously, the current environment is challenging, but we are actively managing our resources to strategically navigate the pandemic and to be well-positioned when business conditions begin to normalize. We will continue to make prudent investments in product development, sales resources, and IT to support growth. We'll also consider any shareholder value enhancing opportunities, including those that may occur as a result of the challenging economic environment and we'll remain value-disciplined and patient as we have the balance sheet to do so.

I thank you for your interest in Acorn. We genuinely appreciate the support of our investors and I'm always happy to speak with investors with questions, concerns, or suggestions about the company. Please contact our investor relations team with questions or to set up a call with me. Thank you, again, for your time today. Everybody, please stay safe and healthy. Operator, I believe that will conclude this call.

CONCLUSION

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