Acorn Energy

Fourth Quarter and Year End 2020 Earnings Conference Call

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CORPORATE PARTICIPANTS

Jan Loeb - *Chief Executive Officer*

Tracy Clifford - *Chief Financial Officer*

PRESENTATION

Operator
Good day and welcome to the Acorn energy fourth quarter and year end 2020 earnings conference call. All participants will be in a listen only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, press star then one on your touchtone phone. To withdraw your question press star than two. Please note, this event is being recorded. I would now like to turn the conference over to Tracy Clifford, CFO of Acorn energy and COO of its Omni Metric 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 2021 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 COVID19 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.

The 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 Omni Metrics will be able to achieve their growth goals in 2021, 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 Acorns form 10k as filed with the Securities and Exchange Commission. Now, I'll hand the call over to Acorn CEO Jan Loeb. Jan.

Jan Loeb
Thank you, Tracy. And good morning to those joining our call. I'd like to start today by saying that I am very proud of the Omni Metrics team, and grateful for how they rose to the challenges we faced over the past year. Despite significant business challenges posed by COVID19, Acorn was able to achieve profitability on a net income basis in the fourth quarter, and positive cash flow for the quarter and full year. These are very significant milestones for our company and ones that we have been working toward for several years.

But what’s even more important, is that we believe Acorn is on track to achieve profitability and positive cash flow on a consolidated basis for the full year 2021 and moving forward. This is particularly significant for Acorn because we have nearly $70 million of net operating loss carryforwards or NOL’s. These NOL’s will shelter our future net income from federal taxes for the foreseeable future, positively impacting our operating cash flow and benefiting our future cash balances and financial position.

Further, we no longer have any debt, as we paid off our line of credit last month. What this means for our shareholders is we now have a growing cash generating and self-funding business with attractive margins and recurring revenue streams. This should make our public equity more attractive to a broader base of investors and puts us in a stronger position to pursue value enhancing investments and opportunities. Importantly, throughout 2020 and the ongoing spread of the pandemic, we were able to remain fully operational without any employee furloughs. We did have experience in interruption in all business development dialogues, particularly within our corrosion protection or CP business, as prospective customers halted procurement discussions and in person sales meetings.

Nevertheless, the strength of our value proposition and business model enabled Acorn to achieve your three year GAAP revenue growth in 2020 and to maintain our cash basis sales at 2019 levels. We also further improved our gross margins to 69.8% in 2020, versus 65.4% in 2019, reflecting the improvement in hardware margins, and an increase in higher margin monitoring revenue as a percentage of total revenue. In addition, the personal challenges we all faced with the spread of COVID, some also face the unpredictable damaging impacts of Mother Nature.

2020 and the beginning of ‘21 has been another period of severe weather patterns from wildfires in California to extreme cold in Texas. Severe weather continues to disrupt and expose the national problem of aging power grids. This increasing incidence of power outages is a driver of backup generator power installations, even in places that historically have not been large markets for us. California, for example, has not historically been a big market for generators, which may now be a big market opportunity for generator OEMs, thereby growing the base of potential endpoints to offer our monitoring and control products and services.

These trends, combined with the very limited penetration of backup generator monitoring in both commercial industrial and consumer settings, as well as the growing base of people who work remotely are important demand drivers, underlying our long term growth outlook. It is estimated that as little as 15% of backup power generators are currently monitored, which supports our long term growth view. In the near term, we believe we have a strong foundation upon which to achieve further top line and bottom line growth in fiscal 2021.

As business conditions gradually return to a more normalized state, particularly in our (INAUDIBLE) with natural gas pipeline operators. In the latter part of 2020, we were able to begin re engaging in sales dialogues with larger companies and we are working to build on that activity this year. To that end, we recently added a new sales engineer to support business development efforts in our pipeline corrosion protection segment, so that we were able to adequately support an expected increase in business development efforts. We also added an additional sales engineer in our larger power generation segment to support expected growth from our focus on the commercial and industrial market segments.

Our growth prospects are also driven by Omni metrics cutting edge technology and solutions and our ongoing investment in new product development and innovation. During 2020, we launched our new smart enunciated solution, which revolutionized circuit enunciator monitoring by providing a five inch touchscreen LCD display on the device. Which combined with our remote monitoring technology, provides real time status and alerts on mission critical circuitry. In late 2020, we also upgraded and launched our next generation Omni pro data management software used in our pipeline corrosion protection solutions.

This software builds upon our prior capabilities to enhance the value and effectiveness of our hero to rectifier monitor and our patriot test station monitors, while also allowing customers to import non on the metrics data. This value added solution solves a key pain point for our pipeline customers by enabling the centralized tracking of critical data and assets on a hardware agnostic basis. We are excited to be re engaging with customer prospects regarding this important new solution. We are also focused on adding sales support behind our Air Guard air compressor monitoring solution, which is still in its early stages of commercialization having been first launched in 2019. In order to deliver greater value to our customers and maintain our technology leadership position in the remote monitoring marketplace, we plan to continue our investments in R&D and new product development. And we expect to launch additional product enhancements and new products this year.

Turning back to our financials, Acorn was successful in substantially strengthening our financial position in 2020, increasing cash by $816,000 to over $2 million at year end. Reflecting $464,000 in operating cash flow and net paycheck Protection Program loan proceeds of $421,000 partially offset by investments in software and new products. Our strength in the balance sheet provides a solid foundation to support organic growth, as well as partnerships or possible tuck in acquisitions of a technology or product that would strengthen our remote monitoring solutions portfolio.

In any scenario, we would closely evaluate any opportunity to ensure that it meets our criteria of being accretive to earnings cash flow and shareholder value, either immediately or certainly within a reasonable period of time. Having forged a strategy that focused Acorn's future on the potential of our Omni metrics business, we have been extremely pleased by its performance and resiliency, particularly over the past year. We believe this strength is due to the value, return on investment and even the environmental benefits that remote monitoring solutions deliver versus resource intensive physical inspection and the significant limits of periodic onside evaluations.

Our clear value proposition, combined with continued low levels of penetration for remote monitoring and IoT services in commercial and industrial markets, continue to suggest their main substantial long term growth opportunities for our business. As our economy stabilizes, and as our larger pipeline industrial customers get back to normal procurement dialogue cycles, we believe Acorn is both poised to aggressively execute on growth opportunities across our expanding base of solutions. All of the reasons I have highlighted, our board and management team remain confident in the potential for Acorn to achieve an annual growth trajectory of at least 20% in 2021, and for years to come, while also maintaining positive operating cash flow and achieving profitability on an annual basis.

Given the opportunities we have identified, our strong capital position, our knowledge and experience team and a tangible value provide to our customers, I am very enthusiastic about our business and about our prospects going forward. We also think we are in somewhat of a sweet spot with the new administration in Washington. Firstly, because of our clean tech business model, and the expected renewed focus on environmental issues and green policy incentives. And secondly, our large NOL position could become an even more valuable asset, if corporate tax rates were to be increased. With that overview, I'll turn the call back to Tracy Clifford, our CFO, to review our financials in greater detail.

Tracy Clifford
Thanks, Jan. This morning, we released our 2020 and fourth quarter and year end results in a press release, and also filed our 2020 10k with the SEC. I'll review some financial highlights compared to the comparable fourth quarter and full year of 2019. On the metrics revenue, grew 8% to $5.9 million in 2020 from $5.5 million in 2019, due to a 15% increase in monitoring

revenue. This was offset by a 3% decrease in hardware revenue. Monitoring growth reflects an increase in the number of units being monitored, while the decline in hardware sales reflects business development disruptions caused by COVID19, particularly in our corrosion protection segment.

Revenue in Q4 of ‘20 was 14% higher than Q4 ’19 as a result of increases in both monitoring and hardware revenue. In accordance with GAAP, hardware sales are deferred and recognized to revenue over the estimated life of the unit, which is three years, thus 2020 revenue on a GAAP basis includes amortization of hardware sales made in 2020 as well as in the prior two years, when we enjoyed strong sales increases. Gross profit grew 15% to $4.1 million in 2020, with a higher percentage of revenue coming from monitoring, which has a higher gross margin and also due to a favorable change in the product mix of hardware.

Gross Margin on hardware increased to 44% in 2020 from 38% in 2019, reflecting a more cost efficient product mix in the corrosion protection segment as well as to reduce costs on new power generation products. Gross Margin on monitoring revenue remains strong at 84% in both 2020 and 2019. In quarter four of ’20, gross profit grew 17% over quarter four ’19, to $1.1 million and gross margin increased 1% to 69% from 68% in Q4 ’19. On the metric (INAUDIBLE) total operating expense increased 4% to $3.6 million in 2020, primarily due to an 11% increase in research and development expense, and a 3% increase in SG&A expenses.

This increase in R&D was for continued development of next generation products, as well as potential new product lines. In Q4, Omni Metric’s operating expenses increased 4% to $888,000 as compared to the prior year quarter. Omni Metric’s his operating income increased to $580,000 in fiscal 2020 versus operating income of 177 in the prior year period, principally due to increased revenue and higher gross margin offset by slightly higher operating expenses. In Q4, Omni Metrics operating income increased to $222,000 compared to $89,000 in Q4 ‘19, attributed to the same drivers as the annual increases.

Acorn's corporate SG&A costs increased 2% to $890,000 from $876,000 for the full year 2020 compared to 2019 and increased 8% $213,000 from $197,000 and fourth quarter 2020 compared to the fourth quarter 2019. Both the increase for the full year and the fourth quarter increase was due to higher professional fees. Acorn recognized a gain of $421,000 in 4Q ‘20 and the full year 2020 on the forgiveness of the Omni Metric’s paycheck Protection Program loan, including the gain net income attributable to Acorn shareholders improved to 69,000, or zero cents per share in 2020, as compared to a net loss of $618,000, or two cents loss per share in 2019.

Q4 of ‘20 net income attributable to shareholders improved to $417,000, or a penny per share from a net loss of $61,000 or zero cents per share in Q4 ‘19. Excluding the paycheck Protection Program gain, Acorn would have recorded consolidated Q4 net income before non-controlling interest of $2,000. As you may know, Acorn uses cash basis sales as a performance measure to supplement our GAAP revenue growth trends. Cash basis sales differ from GAAP revenue because we differ and recognize revenue from hardware sales over a three year period and we differ and recognize revenue from monitoring contracts over the period of service which is typically one year. We invoice upon hardware shipment or monitoring renewal and our terms are typically 30 days.

Cash sales are typically greater than GAAP revenue during periods of expansion when we're able to be active in new business generation. Given the impact of COVID19 on our pace of new hardware sales during 2020, our full year cash sales only modestly exceeded GAAP revenue in the same period, which we view as a positive outcome. For the full year, our cash basis sales has held steady at $6 million in fiscal 2020 in fiscal 2019. Cash sales were also flagged for the second half of 2020 versus the second half of 2019. In Q4, our cash basis sales were $1,517,000 versus 1,557,000 in Q4 ’19. We're encouraged that we're able to maintain our cash sales throughout 2020 at 2019 levels despite the impact of the pandemic. And we do expect that cash basis sales will once again exceed GAAP revenue, as the impact of the pandemic recedes, and we return to more normal business practices and sales trends in 2021.

As it relates to cash sales across our two segments comparing fiscal 2020 to 2019, cash basis sales increased by $169,000 to $5.2 million in our power generation segment, while our CP segment declined $162,000 to $807,000. Cash generated from operating activities improved to $464,000 in 2020, including $164,000, generated in 4Q. At year end 2020, consolidated cash increased $2.1 million from $1.2 million at December 2019. This increase of $816,000 is due to cash generated from operating activities, plus the PPP net proceeds offset by some investments in software and development.

Omni Metric’s outstanding balance on its credit line was $149,000 as of December 31st, 2021. And as Jan previously mentioned, we paid this line off in full in February. And given the strength of our consolidated balance sheet, we elected not to renew the line and we let it expire on February 28th, in accordance with its terms. We believe the company's current cash and expected cash flow from operations provides sufficient liquidity to finance the company's existing operations into the foreseeable future. That concludes my remarks. And now I'll turn the call over to the operator and give you all an opportunity to ask any questions you may have. Operator.

Operator
We will now begin the question and answer session. To ask a question, press star then one on your touch tone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed, and you would like to withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster. The first question comes from Richard Sosa, who is a private investor, please go ahead.

Richard Sosa
Hey, Jan, how are you doing?

Jan Loeb
Good morning, Richard.

Richard Sosa
First of all, congratulations. As you know, I've held the stock for what seems like over 10% of my life. So, congratulations on your first quarter of profit on an operating basis and the cash flow basis. You’ve been talking about this for many years and it's been a long road and it's great to finally see it. So, definitely congratulations to you and your entire team.

Jan Loeb
Thank you.

Richard Sosa
So I had two questions. Last year, you talked a little bit about a slowdown in the industrial markets in both of your end markets. Have you seen any kind of pickup in the first quarter, specifically on the generator side?

Jan Loeb
The slowdown that you're referring to in the commercial industrial side is really from the OEM side. So, for example, Generac has said that their commercial industrial side generated sales has slowed because their residential side has picked up and has been growing very significantly. We have not seen a drop in the commercial industrial side, because that has been our focus. And like the residential side, has a very low penetration rate. So, our focus is commercial and industrial.

And since that's our focus, we've seen consistent growth in that area. The residential side of our business is where we're not so focused, because there is significant competition from the OEMs on the residential side. That business has been growing for the OEMs. But for our standpoint, our focus is commercial and industrial. And that continues to grow very nicely for us.

Richard Sosa
And you talked a little bit about the new administration and a new potential friendly administration, makes a lot of sense. Yep. Democratic administration, it would make sense that Omni Metrics is a darling in their eyes, helps companies be more efficient, helps generators be more efficient, helps pipelines be more efficient. All of that is very good. Have you heard anything specific to like specific policies that could benefit Omni Metrics?

Jan Loeb
We've not heard it yet, of any specific policies, but just in general, we're saying since green is going to be a focus, and the administration has said it's going to be a focus and going to zero emissions. So, remote monitoring is certainly an area that allows companies to do that, or to get closer to that goal. So, we think we're in the right spot. But we've not seen or heard any direct policies that would impact us today.

Richard Sosa
That's great. And I do have one more question. But I'll go back in the queue and let anyone go, if there's somebody there.

Operator
We actually don't have anybody in the question queue currently. Richard, if you'd like to ask your next question.

Richard Sosa
Oh, that's great. Sure. So, I noticed you did a presentation with Raj in December. And I see that you're attending a conference, virtual conference this week, later this week with Maximum, I believe? Is this something you plan to do over next few months, to be, I mean, you've done a great job telling your story, obviously. But are you going to do more of these and get in front of new investors?

Jan Loeb
If we're invited, it certainly would be hope that I can do that. I think our story, I think we've reached a milestone, which we've tried, as you noted before, is to get to profitability on a

consolidated basis. And I think that, now that we've reached that milestone, our next milestone is to show that we have significant growth potential and the profitability that that growth can bring. As you note, we have a 70% gross profit margin on our business. So, as our growth ramps up, the profitability story becomes a very large one. And so, I hope to bring focus to that over the next year or so and conferences will help me accomplish that.

Richard Sosa
That's great, Jan. Congratulations and I look forward to your continued success at Acorn/Omni Metrics.

Jan Loeb
Thank you, Richard.

Operator
The next question comes from Peter Rabover with Artko Capital. Please go ahead.

Peter Rabover
Hey, Jan, congratulations on reaching profitability and cashflow positive. I wanted to get some questions on the metrics for the hardware, the relationship between the hardware and the recurring revenue. And so, I think Tracy might have said it, but what were the hardware sales this quarter, $650,000 or something? Am I correct on that?

Jan Loeb
Tracy? Tracy, do you want to handle that?

Operator
Tracy, this is the operator, your line might be muted. If you're speaking, we cannot hear you.

Tracy Clifford
Yes, I'm sorry. I'm sorry, Peter, could you repeat your question? Hardware sales (INAUDIBLE) Hardware cash sales?

Peter Rabover
Yeah, I guess. I guess an increase in deferred revenue, whatever metrics you guys use to track hardware sales.

Tracy Clifford
Sure. We typically use metrics across our product lines as well, because the gross margin differs (INAUDIBLE) product. As it relates to cash sales, compared to the hardware sales, as I was stating, the hardware is amortized over three years, the hardware sales are actually amortized over three years. So, the cash that is the difference between the cash sales metric and the actual GAAP revenue that we recognized. So, there's actually three years of amortized sales coming into the GAAP revenue on a monthly basis. So, that kind of explains the difference as our hardware sales increase. Of course, the layers of GAAP revenue revenue that are amortized in will also increase.

Peter Rabover
Right. So, I'm sorry, but what was the number of both?

Tracy Clifford
Our full consolidated sales across, I don't believe I gave hardware sales separately on the cash basis. Our full hardware sales, and monitoring sales for cash basis were $6 million in both 2020 and 2019.

Peter Rabover
Sorry, I was asking for the quarter. What were the hardware sales for the quarter?

Tracy Clifford
Let me just pull that for you. Give me just a moment.

Peter Rabover
Okay, let me ask this question. So, while she's looking, I guess, do you guys have kind of a good idea on, and I think I sort of did in the past, but I don't want to say this number without, so it doesn't come out incorrect. But for every x amount of dollars in hardware sales, whether cash or GAAP, what is your monitor and revenue base increased by?

Jan Loeb
You can't really use that number because our hardware sales, for example, a rectifier sale is about, we'll call it $1800 a unit. And the generator, a monitor sale is maybe $300 a unit. So, you just can't say for each dollar, you'd have to look at the units. Not, the units in total versus a volume sales number.

Peter Rabover
Okay, do you have an ARR number for the for the monitoring revenue?

Jan Loeb
Yeah. So, you could say kind of on average, for every unit we sell, it's approximately $150 a year in monitoring revenue. On average.

Peter Rabover
Right. Do you have like an average hardware price? I mean, I guess I'm just trying to get better metrics to kind of highlight the value of the company in terms of, given your high renewal rate, and so an increase hardware, which, I think it was like $400,000 or $500,000 for 2020 which was clearly a down year. And it sounds like fourth quarter was least $600,000, 700,000. Just trying to get gauge what the ARR base for the monitoring revenue is? Which is what really drives the gross margins, the gross profits and the value of the company.

Jan Loeb
Yeah, I don't know that we can give it to you here.

Peter Rabover
Okay. Fair enough.

Tracy Clifford
And, Peter, just to circle back to your question. The hardware sales in fourth quarter '20 were $416,000 compared to $545,000 in quarter four '19.

Peter Rabover
Really?

Tracy Clifford
And again, that's across both segments.

Peter Rabover
I mean, your year to date number in the third quarter for Hardware sales was $1.5. And for this quarter, it's $2.15. So, I'm just kind of confused on what the gap is.

Tracy Clifford
Those are going to be accessories. I can put together a reconciliation for you, and we can circle back.

Peter Rabover
Okay, fair enough. We can circle back. I'm just trying to gauge how the hardware sales are going, basically.

Tracy Clifford
Certainly.

Peter Rabover
And I guess my second question would be, what the--you guys have $2 million in cash flow, you are cashflow positive. And I guess, I know it’s a small about, like $2 million on, but the market caps not that big. So, I'm just curious what your plans with the cash flow going forward are?

Jan Loeb
So, we would use it to support our growth, number one. Obviously, we've said in our remarks that we expect the least 20% growth in revenue in 2021 and beyond. So, we'll need some working capital increases for inventory, receivables, etcetera. So, as we hopefully ramp up our growth, I would say that the cash right now would be used to support the growth of the company.

Peter Rabover
Okay. Thank you. That's all I have.

Jan Loeb
Thank you.

Operator
Again, if you have a question, press star then one to be joined into the queue.

Jan Loeb
Operator, are there any more questions?

Operator
It appears we have no more questions. So, this concludes our question and answer session. I would now like to turn the conference back over to Jan Loeb for any closing remarks.

Jan Loeb
We are all well positioned to return to normal growth trends and to reach sustainable consolidated net profitability in fiscal 2021. We will continue to look for growth opportunities in

the markets we serve or complimentary accretive opportunities. Once again, I thank you for your interest in Acorn. We appreciate the support of our shareholders and I'm happy to speak with investors about the company. Please visit Maxim group's website for information on their emerging growth virtual conference 2021, which is taking place this week on the maximum website. You can register to view our presentation, which will be available this Thursday, March 18th. You can also 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 this call.

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