Acorn Energy
2nd Quarter 2021 Earnings

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PARTICIPANTS

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

Jan Loeb – *Chief Executive Officer*

PRESENTATION

Operator
Good day, ladies and gentlemen. Welcome to the Acorn Energy Second Quarter Conference Call. At this time, all participants are in listen-only mode. Later we'll conduct a question and answer session, and instructions will be given at that time. As a reminder, today's conference is being recorded.

I'd like to turn the call over to Tracy Clifford, CFO of Acorn Energy and COO of its OmniMetrix subsidiary. Ms. Clifford, 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 in nature. These statements are subject to various risks and uncertainties. For example, the operating and financial performance of the company in 2021 and in future years is subject to factors such as risks associated with disruptions to business operations and customer demand resulting from 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, and the impact of the COVID-19 pandemic, 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 nor OmniMetrix will be able to achieve their growth goals in 2021 or in future years. The company also undertakes no obligation to disclose any revisions to these forward-looking statements to reflect events or circumstances after the date made. A full discussion of the risks and uncertainties that may affect the company is included in risk factors on Acorn’s Form 10-K as filed with the Securities and Exchange Commission.

Now I'll turn the call over to Acorn's CEO. Jan?

Jan Loeb
Thanks, Tracy. Good morning and thank you for joining today's call. This morning Acorn reported another strong quarter of improved results, continuing to build on the progress we are making in our remote monitoring business.

In Q2 2021, we achieved revenue, gross profit, and net income growth and our third consecutive profitable quarter. Year-to-date, our revenue increased by over $500,000 to $3.3 million, and the majority of this increase fell directly our bottom line as net income improved to a small profit from a loss of $316,000 in the year-ago first half. Having moved the business into profitability, we are also well-positioned with a large net operating loss carryforward of nearly $70 million to shield future taxable income and enhance our cash flows.

Our year-to-date GAAP revenue growth of 18% is in line with our long-term goal of 20%, while our all-important cash basis revenue grew an impressive 25% to $3.5 million from $2.8 million in the first six months of 2021 versus a year ago. Cash basis revenue is a non-GAAP measure that we use to track our business progress. A reconciliation of cash basis revenue to GAAP revenue is provided in our press release, with the primary difference being that cash basis revenue includes deferred hardware and monitoring revenues that are amortized over future periods for GAP.

Gross profit grew 25% due to revenue growth and gross margin improvements. Gross margins have been improving over time due to a variety of ongoing initiatives, including the launch of next-generation monitoring equipment and services that offer more value-add to the customer, as well as the benefit of ongoing design improvements and cost controls.

We continue to invest in new product initiatives for existing markets as well as related industrial, IoT, and remote monitoring opportunities that can support revenue and margin improvements. For example, we launched a remote AC disconnect solution just last week at the NACE, National Association of Corrosion Engineers, conference, and it received excellent interest.

Our product development efforts are led by our first class design and engineering team, and our products are backed by our experienced and knowledgeable technical support and sales engineering staff. We added two new sales engineers late in the first quarter to support business development efforts. We have already seen benefits from these hires and expect more progress going forward, assuming business conditions continue to normalize.

The deep experience and excellent customer service of our OmniMetrix team is a key component of our success and competitive advantage. We serve large-scale but substantially unpenetrated industrial markets with growing IoT needs, which present significant long-term growth opportunities to our company.

Our financial position remains strong, with cash of approximately $2 million and no outstanding credit line debt. This provides strong financial footing on which to continue to grow our business organically as well as to consider value enhancing growth opportunities such as partnerships or possible tuck-in acquisitions to expand our product offerings and strengthen our market position. We are extremely disciplined in evaluating opportunities to ensure they fit with our business and make sense from a capital allocation, risk-reward, and shareholder value standpoint.

Fundamentally, our solutions deliver substantial managerial, environmental, and cost reduction benefits, criteria that are increasingly at the top of the list in corporate decision-making. The alternative to our remote monitoring is ongoing physical inspection of industrial equipment by roving teams in trucks, often working large territories in remote locations at substantial cost and environmental impact. Considering these factors and the current administration's focus on environmental issues and infrastructure spending, our market positioning seems particularly strong.

Sales of new hardware units fueled our growth in the first half of 2021, partly due to our execution of expanding sales initiatives and the rebound of corporate equipment spend that had been restricted last year due to COVID-19 disruptions of customer activity. We are focused on continuing to expand our market share of monitoring equipment sales and the related high-margin recurring monitoring revenue streams that follow.

As we add new endpoints to the monitoring business, I should note that historically in a normal year, which I'm not sure 2021 will fit in that category, OmniMetrix first half revenues represent approximately 45% of full-year revenues.

With that overview, I'll turn the call to Tracy Clifford, our CFO, to review our financials in more detail. Tracy?

Tracy Clifford
Thank you, Jan. And again, good morning, everyone. As Jan mentioned, we released our second quarter 2021 results and filed our Form 10-Q with the SEC this morning. I'll review some financial highlights and then Jan and I will take any investor questions.

OmniMetrix revenue grew 10% to $1.6 million in Q2 '21 from $1.5 million in Q2 '20, driven by a 16% increase in hardware revenue and a 6% improvement in monitoring revenue. The increase in hardware revenue is due to a more receptive sales environment in 2021 versus 2020 which, as Jan mentioned, was impacted by COVID-19 business disruptions and, in particular, higher sales of next-generation products, including our Hero-2 pipeline monitor and Rectifier monitors, versus Q2 last year. Monitoring revenue growth has benefited from a growing installed base as well as efforts to shift our sales focus to commercial and industrial customers from residential.

For the first six months of 2021, GAAP revenue increased 18% to $3.3 million, primarily due to increased sales of custom-designed monitoring hardware and next-generation units, along with growth in monitoring. Gross profit grew 20% in Q2 '21 and 25% in the first six months of 2021, and our gross margin improved to 76% in Q2 '21 from 70% in Q2 '20, mainly due to increased hardware sales to commercial industrial customers versus the lower margin residential customers, increased accessory sales, and growth in high-margin monitoring revenue.

OmniMetrix's operating expenses increased 21% due to an increase in SG&A and higher R&D expenses. The increased SG&A is due to a rebound in business development, travel expenses with the easing of COVID-19 travel and trade show restrictions, compensation and benefits for added sales engineers, increased sales commissions, and ongoing investments in our corporate technology infrastructure.

OmniMetrix generated operating income of $231,000 in Q2 '21 versus operating income of $200,000 in Q2 '20. For the first six months of 2021, OmniMetrix's operating income increased to $498,000 as compared to $149,000 in the first six months of '20. Both fiscal 2021 periods benefited from higher revenue and improved gross margin. Acorn's corporate SG&A costs increased 2% over Q2 '20 to $226,000 in Q2 '21 but declined sequentially from $241,000 in 1Q '21 due to the timing of certain expenses.

Driven by the improved performance at OmniMetrix, Q2 '21 net income attributable to Acorn's shareholders improved to a positive $2,000 from a net loss of $33,000 in Q2 '20. For the first six months of this year, net income attributable to Acorn shareholders improved to $22,000, a $338,000 improvement from a year ago net loss of $316,000.

As Jan previously noted, we utilize the non-GAAP measure of cash basis revenue as a supplement to GAAP revenue to evaluate our business development progress and growth trends. In Q2 '21, our cash basis revenue grew 26% to $1.9 million from $1.5 million in Q2 '21.

Cash basis revenue differs from GAAP revenue because, for GAAP, we generally defer much of the purchase price of hardware sales and recognize it as revenue over the estimated life of the unit, which is currently three years. Similarly, we defer much of our revenue from monitoring contracts and recognize it ratably over the balance of the period of service for GAAP, which is typically one year. A reconciliation of GAAP revenue and cash basis revenue was provided in today's press release.

For the first six months of 2021, cash basis revenue grew 25% to $3.5 million. Also, cash generated from operating activity was $83,000 in the first six months of 2021 versus $78,000 in the first six months of 2020 due to increased revenues and net income, which were partially offset by higher volume of inventory purchases.

We had consolidated cash of approximately $2 million at the close of the quarter compared to $1.8 million at June 30th of the prior year. To offer a more current reference point, our cash balance was $2,039,000 as of August 5th, or last week. Earlier in the year, we paid off our A/R credit line and elected not to renew it, as we believe the company's current cash and expected cash flow provide sufficient liquidity to finance our existing business for the foreseeable future.

One additional item to note this year is our investment in inventory. At the end of 2020, our inventory on hand was valued at $236,000, while at June 30th, 2021, the value was $363,000, and as of August 5th it was $426,000. When looking at the current inventory balance as of August 5th, this equates to an 81% increase from the year-end balance and a 17% increase from the second quarter end balance.

The primary reason for this increased investment in inventory on hand is to stay in front of and mitigate any potential negative impacts to our business from potential shortages and/or long lead times for critical components. We feel we have the capital and the ability to navigate these issues, and thus far we've been able to stay ahead of the demand through proper planning and supply chain management.

I'll conclude my remarks by saying that we are very encouraged about the first half performance of the entire OmniMetrix team and the investments that we're making in our products and technology to gain more market share. We're excited about the opportunities ahead as we continue to expand the scope of our product and service offerings within the current rebounding economy.

And with that, I'd like to turn the call over to the operator to give you all an opportunity to ask any questions. Thank you again for joining. Operator?

QUESTION AND ANSWER

Operator
We'll now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we'll pause momentarily to assemble a roster. Again, if you have a question, please press star then one.

The first question comes from Joe Stein of Morgan Stanley. Please go ahead.

Joe Stein
Well, congratulations, Jan, on a great quarter. Keep up the good work. I heard the comments on the inventory, but are you having any problems getting any of your equipment? With everybody complaining, not that you're in the high-tech world, but are you having problems with any of your equipment that you're picking up to service?

Tracy Clifford
Right, sure. Thank you for your question. I'll take that question. We have really spent a lot of time focused on sourcing secondary providers so that, as we see potential issues crop up with longer leadtimes, we're able to substitute those secondary suppliers in fairly quickly. And we are placing POs for significantly more volume of the parts that we traditionally need in all of our units so that we can ensure that there's no issues.

In the past, we've always been more on time demand where we've ordered smaller volumes at a time and more frequent orders throughout the year. And so, we've taken a different strategy this year, where we're ordering much larger volumes ahead of the need to ensure that we're going to be properly stocked.

Joe Stein
So, you're comfortable building up the inventory.

Tracy Clifford
We are, yeah. We're comfortable.

Joe Stein
So, you think your inventory is adequate, okay.

Tracy Clifford
Right. We're comfortable at the current pace and we feel like we've got, you know, sufficient safety stock. And we started that strategy quite a number of months ago because we really anticipated that the market--or the availability was going to constrict in some of the components that we needed. So, we were really focused on getting that strategy launched very early, and I think it's paid off for us.

Joe Stein
Great. Thanks, Tracy.

Tracy Clifford
Um-hmm.

Operator
Again, if you have a question, please press star then one. At this time, we have no further questions. I'd now like to turn the conference back over to Jan Loeb for closing remarks. Please go ahead.

CONCLUSION

Tracy Clifford
Jan?

Operator
Jan, are you there?

Jan Loeb
Hi. I'm with you. I just want to conclude by saying that, although risks remain regarding COVID-19 variants and their potential economic impact, we are very happy with our business performance, positioning, and its trajectory.

Thank you again for your interest in Acorn. We greatly appreciate your support. And I'm always happy to speak with investors about the company. To set up a call with me or to ask any questions, please contact our Investor Relations team via their contact information on today's press release. Thank you again for your time. Operator, I believe that concludes today's call.

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