Acorn Energy

Third Quarter 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

Tracy Clifford - *Chief Financial Officer*

Jan Loeb - *Chief Executive Officer*

PRESENTATION

Operator
Good day, ladies, and gentlemen. Welcome to the Acorn Energy Third Quarter Conference Call. At this time, all participants are in a listen only mode. Should you need assistance, please signal a conference operator by pressing star zero. Later we will conduct a question and answer session and instructions will be given at that time. As a reminder, today's conference is being recorded.

I would now 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 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 the 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 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 today's date. 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 Loeb, for an overview of our business performance and outlook. Jan?

Jan Loeb
Thanks, Tracy. Good morning. And thank you to those joining today's call. Acorn reported its fourth quarter--consecutive quarter of revenue growth and improved results, reflecting our progress in building our remote monitoring business. Through the first nine months of 2021, GAAP revenue has increased 16% and cash basis revenue has grown 24%. Cash basis revenue is a non-GAAP measure we use to measure our actualized sales growth as it reflects all sales revenue in the period in which the sale is invoiced. GAAP revenue reflects the amortization of deferred revenue over the applicable period, three years for equipment revenue and the period of service from monitoring revenue, which can be one to 12 months. We provide a reconciliation of cash basis revenue to GAAP revenue in today's press release.

Our gross profit grew 22% year-to-date due to revenue growth and gross margin improvements. Gross margin has benefited from design improvements in our next-generation monitoring equipment and services that offer more value to the customer, customized products, and accessories, which carry higher margins as well as progress on increasing our penetration in commercial and industrial markets. We have an exceptional, experienced, and proven design and engineering team, and we continue to invest in new product initiatives for commercial and industrial, IoT and remote monitoring opportunities to support our competitive position and growth.

In Q3, we announced beta testing of a remote AC disconnect called RAD for the pipeline market at the National Association of Corrosion Engineers Conference. This new solution has received keen initial interest and our sales teams are working to advance dialogues into trials. To support our business development and expansion efforts, particularly as business returns to more normal procurement activity, we added two new sales engineers in the first quarter of this year. In September, we announced that OmniMetrix has partnered with Texas-based power solutions specialist to provide remote monitoring and control equipment and services for thousands of backup power generators over the next 12 months. PSS is a leading generator dealer and service provider in the Houston area and a prominent bricks and strand distributor. Generator dealers are our primary customers, and we provide monitoring solutions and programs to meet their specific needs. We hope to build upon this relationship and other dealer relationships moving forward.

We also have a strong financial position, including cash and no debt, which provides a solid base to grow our business organically and to consider other value-enhancing partnerships for growth opportunities. We continue to pursue potential acquisition opportunities to accelerate our growth and strengthen or expand our market position, but remain very disciplined in order to ensure any transaction will create shareholder value. Admittedly, this discipline and a period of lofty valuations creates challenges in finding appropriate deals, but we are confident it is in the company's best interest to remain disciplined in our specific deal objectives.

In Q3 '21 and through the nine months ending September '21, hardware revenue increased substantially 20% and 33%, respectively over the comparable 2020 periods. Hardware sales have been robust due to lifting of COVID-19 restrictions on business meetings, travel and trade shows, and hardware sales are also benefiting from the wireless operators decision to sunset 3G monitoring technology in favor of LTE currently and 5G in the future. This sunsetting has positively impacted hardware sales as customers upgrade to next-generation units.

While sunsetting also has a structure negative impact on monitoring revenue growth as a result of disconnects by these customers, we do not upgrade or potentially switch to competitors. We have seen some impact on our business from global supply chain issues, but we have been able to mitigate these issues through proactive management, internal planning and by purchasing safety stock inventory, an option we can pursue given our solid financial position. We believe in the supply chain constrained environment that there may be opportunities in future quarters to potentially acquire additional market share relative to competitors who may not have the financial means to purchase excess levels of safety stock inventory.

To address inflationary pressures on input costs, we implemented a 15% to 20% hardware price increase effective September 1. At the current time, we do not anticipate either supply issues or cost pressures to have a material adverse impact on our business, but we are tracking the changing supply chain issues on a daily basis to ensure we remain well positioned.

Given the fact that we have had several quarters of profitability, I would like to remind investors that Acorn benefits from NOL carryforwards of nearly $70 million as of year-end 2020. Our NOLs should largely shield the company from cash income taxes for the foreseeable future and therefore provide a significant benefit to cash flow. While currently, Acorn has neither accrued nor paid income tax expense through the first nine months of 2021.

Stepping back to look at the bigger picture. Our long-term value proposition to our customers and our confidence in Acorn's growth opportunity is really rooted in the substantial cost reduction, managerial benefits, and environmental benefits we deliver. These issues are of increasing interest and importance for corporate decision-making and yet the market penetration for remote monitoring solutions remains substantially underpenetrated. Thus, we continue to see plenty of opportunities for continued growth, particularly in large industrial markets that we serve and adjacent markets for remote monitoring, control, and related IoT services. We have a stated goal of 20% average annual growth, and we expect to exceed 20% growth of cash-based revenue in 2021, which is the primary metric we use to evaluate our growth.

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

Tracy Clifford
Thanks, Jan. I will review the highlights of our financials, which were released and filed with the SEC this morning. And then we'll take investor questions.

OmniMetrix's GAAP revenue grew 12% to $1.7 million in Q3 '21 from $1.5 million in Q3 '20, including a 28% increase in hardware revenue and a 4% improvement in monitoring revenues. This increase in hardware revenue is primarily due to the fact that our current and potential customers are more accessible with the lifting of COVID-19 restrictions and budget holds have been released on corporate spend as compared to Q3 '20, which was more impacted by COVID-19 disruptions. Also, as mentioned, the hardware revenue was impacted positively by the sunsetting technology.

Monitoring revenue growth is primarily due to our customer mix being more heavily weighted to commercial and industrial customers than in prior years. In the first nine months of 2021, GAAP revenue increased 16% to $5 million due to increased hardware and accessory sales, including sales of custom design monitoring units and the change in customer mix of units being monitored. Gross profit grew 15% in Q3 '21 and 22% in the first nine months of 2021. And our gross margin improved to 73% in Q3 '21 from 71% in Q3 '20. The improved gross margin is due to several factors, including sales of the next-generation products that Jan mentioned, an increasing focus on higher-margin commercial and industrial sales, and a related increase in the volume of accessory sales.

Operating expenses increased 13% at OmniMetrix, principally due to increases in compensation and benefits expenses as a result of new hires, annual performance-based salary increases, and higher sales commissions, along with increases in IT expenses for consulting and managed services. OmniMetrix generated operating income of $265,000 in Q3 '21, a 26% improvement over Q3 ‘20. Year-to-date, OmniMetrix grew its operating income more than 100% of the comparable prior year period. With improved operating performance at OmniMetrix, Q3 '21 net income attributable to Acorn shareholders improved to $23,000 or net zero per share from a net loss of $32,000, which was also $0 per share in Q3 '20.

As Jan already noted, our cash-based revenue grew 24% for both the third quarter and the 9 month period as compared to the same periods in the prior year. We believe this growth is evidence of the quality of our products and the customer centric focus of our technical support team. As we continue to focus on gaining market share in the commercial and industrial segment of the market and to introduce new product enhancements in response to customer feedback, we are bullish that we can continue our current sales trends.

Now speaking about cash. Cash generated from operating activities was $323,000 in the first nine months of 2021 versus $300,000 in the first nine months of 2020 due to increased net income and deferred revenue, offset by investments in working capital including inventory and an increase in accounts receivable. In the first nine months of 2021, we have invested $214,000 in our IT infrastructure related to the redesign and upgrade of our user interface, the design of a new cloud server environment that will provide flexibility for growth and improve data response performance for our customers, and in purchases of new computer equipment. In the same period in 2020, we invested approximately $90,000 primarily in software customization. We had consolidated cash of approximately $2 million at September 30, 2021, which was the same level at September 30, 2020 and also at June 30, 2021. More currently, our cash balance on November 8 was $1.9 million as we've been able to maintain a healthy cash balance even with significant investments in inventory and technology.

As Jan alluded, our inventory approximately doubled to $477,000 at September 30, 2021 from $236,000 at September 30, 2020. And as of November 8, our inventory was $613,000. This investment is a proactive move to stay in front of and mitigate potential impacts to our business from shortages, long lead times, and shipping delays for critical components. We feel we have the capital and the ability to mitigate impacts to our business through proper planning and supply chain management. And thus far, we've been able to do so.

As we've noted in prior calls, earlier in the year, we paid off our AR credit line and elected not to renew it as we believe the company's current cash and expected cash flow provides sufficient liquidity to finance our existing operations for the foreseeable future.

I'll conclude by saying that with the financial results of the first nine months of 2021, we continue to be encouraged and excited about the future opportunities for OmniMetrix's growth. We have the utmost confidence in the quality of our products, the dedication and expertise of our people and the company's ability to continue to provide first-class products and services to meet the changing needs and exceed the expectations of our current and future customer base.

With that, I'd like to turn the call over to the operator to give you all an opportunity to ask us any questions. Thank you so much for joining.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask your question, you may press star then one 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. We will now pause for a moment to assemble our roster.

Our first question today comes from Richard Sosa, a private investor.

Richard Sosa
Hi, good morning, Jan, and Tracy. How are you?

Tracy Clifford
Good morning.

Richard Sosa
So congratulations on the quarter. As you know, I've been a long-time investor. And as I tell everyone that look, it's slow and steady wins the race, it's been great that you've been able to manage through the ups and downs of the business and just the markets in general. So congratulations on this quarter, especially on the hardware side. I mean it’s probably one of the best quarters I've seen in terms of--in a challenging environment and getting hardware to customers. So I had a few questions on that. One, how much of the hardware growth do you think was from the sunsetting versus just new business?

Jan Loeb
I would say that today new business most probably was about 10% to 12% and of the growth and the balance would be sunsetting.

Richard Sosa
Okay. So right 50/50-ish kind of. Okay. And then on the--

Jan Loeb
--And I would say that sunsetting in our customers' mind, sunsetting is pushing new sales somewhat to the background. And the ability to get new generators is pushing new sales somewhat to the background--are very backlog right now in a new generator demand.

Richard Sosa
That makes sense. And I’ve read a lot about that. The partnership you announced or the order you announced with the PSS. Has any of that come in yet? Or is that kind of a 2022 thing?

Jan Loeb
A little bit has come in. But it's mainly a 2022 event.

Richard Sosa
Yeah. It's a pretty significant order. So I'm pretty happy to see it. It's one of these--I mean it looks substantial, correct?

Jan Loeb
Well, it's significant in many ways, besides the fact that it's a large number of units. It's for Briggs & Stratton units. So since you've been following the company for a long time, that Generac is where the lion's share of our monitoring has been historically. And we've tried to diversify away from that, mainly going into the commercial and industrial area.

Kohler is also a very big factor. But Briggs & Stratton, in general has not been a big factor in the generator market. As you know, Briggs & Stratton Corporate has had their financial problems. And they were recently bought out by private equity. So we hope to see in the future a significant uptick in Briggs & Stratton business. And this was kind of the first piece of it. That's why we chose to highlight it.

We generally don't put out press releases on new customers, but because this was a significant, in terms of size, but from a strategic standpoint, it was also significant because of Briggs & Stratton.

Operator
And again, if you do have a question, please press star then one to join our queue.

Our next question comes from Larry Karlin, private investor.

Larry Karlin
Okay, two things. Number one, I would like to know how much we earn if anything, in pennies or cents prior to taking the tax loss revenue off.
Number two, I would like to know why we have this conference call? I've been in it for the last year, year and a half. I'm a long-term investor, have 50,000 shares, no big deal. But I think we're spending money for no reason because I never seem to get a feeling there's more than two or three people on the conference call. And why we have these calls rather than just talking about the earnings we have prior to the tax loss carryforward and our growth in detail on the news. That's it. Thank you.

Jan Loeb
Okay. Larry, I'll answer your second question first. And then I'll let Tracy answer your first question.

Firstly, right now on the call, since I actually see who the people are on the call, we have approximately 25 people on the call. So there is a significant amount of investor interest. Obviously, we're a very small company. And I hope over time, it will continue to grow as it has in the past. So that's number one.

Number two is the conference call, which does not cost a lot of money, relatively little, is a very efficient way for our shareholders to hear what's going on at the company and to provide our shareholders the ability to ask management questions. So all shareholders can benefit from the answers that are received. So I think that the--having these calls are very beneficial to our shareholders.

Tracy?

Okay. I'll answer your first question first then --

Tracy Clifford
Hi. Hi, Jan. I'm on.

Larry, I'm not sure I fully understand your question. But our net income for the 9-month period is, as we stated in the script was $45,000. And because we have $70 million in net operating loss carryforwards, we don't record any reserve or anything like that in our financials against our net income. So what you see actually in our financials that we file and in our earnings release is the income before income taxes because we won't have any income tax expense applicable for quite some time because of the carryforwards.

Larry Karlin
My real question is, when can the company show $0.03, $0.04, $0.05, $0.06 in earnings to justify a move in the stock?

Tracy Clifford
Understood. Well, as we have been progressing at the 20% growth rate. Our expectation is we're going to continue to have double-digit growth, hopefully. And certainly our objective is to have a return to our shareholders, but it is going to be largely dependent in the continued pace of our growth. And also if we are able to identify, as Jan discussed in the script, identify an

acquisition that we can bolt on as well that will assist in the organic growth that we're experiencing at a faster pace.

Larry Karlin
Thank you.

Operator
And our next question is a follow-up from Richard Sosa, private investor.

Richard Sosa
Yeah. Jan, I accidently hung up. I had a question about the CP unit. Just I saw that it's been turning to the positive side. And it was really happy for me to see it. Do you see those trends continuing?

Jan Loeb
Definitely. And CP--CP was the part of our business that was impacted most by COVID. Because in the CP business, we don't sell to dealers, we sell to the actual end customer. And the end customer is usually a large utility or a large pipeline company. And those companies had in place the COVID restrictions on meetings, et cetera. So it was difficult for us to sell into that market during COVID. So now that has opened up, we expect to see a churn in that business. And then also, as you heard on my call, the RAD is a product for the CP market. And we hope that, that also will generate significant interest and growth in the CP business.

Richard Sosa
And should that be a competitor that does the RAD?

Jan Loeb
I'm sorry. Richard, can you say that again?

Richard Sosa
Is it currently a competitor in the CP segment that has a product that can remotely disconnect?

Jan Loeb
No, right now, we have the lead, we have a patent. I mean one of our competitors is certainly saw it at the show. And our understanding is trying to come up with one. But right now, we're the only one.

Richard Sosa
No, I love it. The best way to get around the hiring problems that a lot of companies are facing is technology and you guys provide that. So I'm very excited.

Jan Loeb
Yep.

Operator
If you have further questions, please press star then one to join our queue.

At this time, I’m not showing further questions. So I like to hand the call -- okay. And actually, looks like we do have some people in queue. So give us just a moment here.

And our next question comes from Joel Sklar, private investor.

Joel Sklar
Good morning, Jan, and Tracy. A very good quarter, so congratulations on that. And a response to an earlier question. I have to say, I for one very much appreciate the quarterly conference call, so thank you very much. And my question has to do also with the CP market. Is there any way you can give us an idea of what the total addressable market is? I know you may be a little difficult that you have different devices now that you're providing. Some of it is brand new and maybe replacing things that were done more manually. But if there's anything that you--any color you can give us on the size of the CP market for this type of equipment? I would really appreciate it.

Jan Loeb
Okay. The answer is I can't really give you a real answer. Because there's no industry data out there and there's no CP association that compiles the data. I can give you really an off, but tough answer just based on the number of our customers and the miles of their pipelines. But every customer is different as to where they have their rectifiers placed. My guess would be it's about $100 million market.

Joel Sklar
Now would that be for equipment as versus like ongoing monitoring? Or how would you categorize that $100 million? Would it be just the hardware itself? Or does that include--

Jan Loeb
--No. It’s both.

Joel Sklar
Okay. Thank you.

Operator
Our next question comes from Michael Zuk, private investor.

Michael Zuk
Good morning. Could you enlighten us, are there any opportunities in carbon capture or in methane monitoring that we could take advantage of?

Jan Loeb
Hi. Good morning, Michael. The answer is I don't know. And it's not something that we really have looked at seriously. I know that in terms of--let's say, there are some companies that are involved with piping like CO2. And so CO2 is very corrosive. So we've been talking to some of them about monitoring on their pipelines. But I don't know exactly now what area of methanol carbon capture you're talking about. But in general, it would be--have to be on a pipeline, and we would monitor that pipeline. If there's some kind of pipe that's taking the carbon, the CO2, or the methane from point A to point B.

Michael Zuk
And then a potential follow-up question. With the advent of hydrogen as an alternative fuel, you think there'll be any opportunity in monitoring the production of hydrogen?

Jan Loeb
Again, there could be an opportunity. It's not an area we are focused on.

Michael Zuk
Well, I'm just trying to open up markets for us.

Jan Loeb
Okay. I appreciate that. And if you have some interesting thoughts about it, I'm open.

Michael Zuk
Well, you know what. I will send you an e-mail with some suggestions and perhaps a couple of referrals. Happy to do that because I'm a long-time shareholder. And I like what you have accomplished with the company.

Jan Loeb
Appreciate it. And yes definitely, we will follow up on your e-mails.

Operator
Our next question comes from Joseph Stein with Morgan Stanley.

Joseph Stein
Jan, good morning. I just want to congratulate you on the quarter. Thank you for having the call. I'd love to see you find an acquisition so we could grow the revenues faster, but I'm sure you're looking and just keep up the good work. And I'm happy to have this call to keep us educated.

Jan Loeb
I appreciate it. Thank you very much.

CONCLUSION

Operator
And again, if you do have further questions, please press star one.

And at this time, I am showing no further questions. So I would like to turn the call back to Mr. Jan Loeb for some closing remarks.

Jan Loeb
Thank you again for your interest in Acorn. We are very pleased with our business performance and with our outlook, both near and long term. We greatly appreciate your support and interest. And I'm always happy to speak with investors or prospective investors about the company. And also, as you heard, if you have some interesting business opportunities. So please contact our Investor Relations team, whose contact info is on today's press release to set up a call with me or to ask any questions.

Thank you, again. Operator, I believe that concludes today's call.

Tracy Clifford
Thanks, everyone.

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