Acorn Energy

First Quarter 2022

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CORPORATE PARTICIPANTS

Tracy Clifford – *CFO of Acorn/COO of OmniMetrix*

Jan Loeb – *Chief Executive Officer*

PRESENTATION

Operator
Good morning, and welcome Acorn Energy First Quarter 2022 conference call. All participants will be in 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'll be an opportunity to ask questions. Please note that this event is being recorded.

I would like to turn the conference over Tracy Clifford, CFO of Acorn Energy, and COO of its OmniMetrix subsidiary. Please go ahead.

Tracy Clifford
Thank you, and welcome, everyone, to our conference call today. 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 2022 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 any additional impacts from COVID-19 or its variants, 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 2022 or in future years. The company undertakes no obligation to disclose any revisions to these forward-looking statements to reflect events or circumstances occurring after today. 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 Jan Loeb, Acorn’s CEO, for an overview of our first quarter 2022 performance and business outlook.

Jan?

Jan Loeb
Thank you, Tracy. Good morning, and thank you all for joining today's call. OmniMetrix continued its solid growth momentum in Q1 2022, driven by our industry-leading solutions and track record for quality, excellent customer service, and a compelling return on investment. Accordingly, we have started the year ahead of pace towards achieving our goal of 20% average annual growth, with Q1 2022 cash basis revenue up approximately 26% over Q1 2021. Cash basis revenue is a non-GAAP measure, which reflects the cash value of invoiced hardware and monitoring sales recorded in a given period. We use this metric internally to evaluate our business performance and growth trends.

Under GAAP, hardware sales are typically amortized over a three-year period and prepaid monitoring revenues are amortized over the term of the monitoring period, which is typically 12 months. We provide a reconciliation of cash basis to GAAP revenue in our press release.

In periods of sales growth, cash basis revenue will tend to exceed GAAP revenue and net cash flow can exceed reported operating income, as we saw in our Q1, with cash basis revenue outpacing GAAP revenue growth. Strong cash basis growth is a leading indicator for GAAP revenue trends in future periods.

Our first quarter performance was driven by monitoring hardware sales. As we have seen in recent periods, hardware sales benefited from the wireless operators deciding to no longer support legacy 3G technology in favor of their investments in LTE and 5G technologies that provide superior bandwidth and performance. This sunsetting of technology used in older monitoring devices provides a boost to hardware sales, as customers upgrade to new equipment. However, the upgrade cycle does not benefit near-term monitoring revenue as new units assume the remaining prepaid monitoring plan of the units being retired.

There are also some monitoring disconnections for customers who choose not to upgrade, or who may switch to competitive products. AT&T's 3G sunsetting occurred in February 2022, but there are still a significant number of 3G units out in the field. We expect the bulk of those remaining units will be replaced over the balance of 2022 to continue a trend of relative hardware sales strength. We believe we have the most innovative design and engineering team in the markets we serve. To maintain our leadership position, we continue to invest in developing product enhancements, as well as developing potential new product lines, particularly in underpenetrated commercial industrial markets, where we see tremendous opportunities for growth with attractive margins.

We announced a partnership last year with Houston, Texas-based Power Solution Specialists to provide remote monitoring and control equipment and services for backup power generators. Power Solutions is a leading generator dealer in Texas, and a prominent Briggs & Stratton distributor. What makes this partnership noteworthy is Power Solutions commitment to bundling our monitoring solutions with Briggs & Stratton generator sales. Historically, Generac and Kohler generator dealers have been our biggest customers. We are working to build on this relationship with Power Solutions, and believe we can utilize this model to develop similar dealer relationships.

I'd like to briefly comment on the macro factors that oil [ph] companies have had to deal with over the past year, including the pandemic and supply chain disruptions and inflation. We feel we have been able to manage through these issues with a combination of management planning and advanced procurement of critical supplies and components, and we have also made some design adjustments to accommodate parts availability.

Additionally, last September, we implemented a 15% to 20% price increase on hardware and equipment to help offset rising input costs. We are contemplating additional price adjustments to be implemented possibly by midyear. We will continue to evaluate the environment and take further steps, in terms of inventory pricing or other factors if necessary.

With respect to the threat of inflation, there is a silver lining for us, in that rising prices can actually be a positive for our business. OmniMetrix solutions reduce the personnel, travel time, emissions, and overall carbon environmental impact required to monitor and manage critical assets and industrial systems. As these costs go up, our value proposition increases. Combine that with an aging energy grid and increasing severe weather patterns, and our monitoring solutions become even more valuable to our customers.

Remote Monitoring is significantly less expensive, more effective, and more environmentally-friendly than sending inspection teams in trucks to remote locations. For clients and potential clients, we believe that the time to value and ROI for OmniMetrix solutions has never been more evident.

We are also fortunate to have significant working capital and financial strength to invest in our business and to manage our inventory, including $1.3 million of cash and no debt. We believe this advantage could allow us to gain market share versus more or less [ph] financially stable competitors. We have invested several hundred thousand dollars in fiscal 2021 to stay ahead of backorders and out of stock components.

Our strong financial foundation also enables us to continue to pursue growth opportunities both organically, or through value-enhancing opportunities, including partnerships and potential acquisitions. We regularly monitor our markets for external opportunities, and we remain committed to a disciplined approach, whereby any external ventures would need to be accretive to our growth and enhance our market position, with the intent to build value for our company and shareholders.

We live in an information age of big data, where industrial clients are increasingly embracing data and information to improve industrial processes and to avoid equipment malfunction. Remote monitoring equipment and systems provides information necessary for our customers to improve their internal operations. Timely maintenance, improved efficiency, and reduced downtime of critical equipment can provide significant cost and bottom-line improvements.

We continue to see significant internal opportunities for growth in the underpenetrated commercial industrial markets that we serve, as well as in related market opportunities for remote monitoring, control, and related IoT services, where we have technology expertise. One area we are exploring is expanding our IoT offerings to help our customers take advantage of demand response or demand management programs offered by many utilities to energy consumers, including industrial consumers, whereby the customers can receive financial incentives for reducing their energy consumption during peak periods of energy demand or undersupply.

We have the technology to turn on backup power generators remotely on demand for our customers. We believe this could be an interesting service opportunity. To the extent that expansion increases our profitability, it's important to note that we have more than $70 million of net operating loss carry-forwards NOLs would largely shield our profits from cash income taxes for the foreseeable future. That's benefiting the potential free cash flow available to the company.

Before I pass the call back to Tracy, I would like to note that our annual renewable revenue, or ARR, was approximately 49% of our total sales in Q1. By continuing to grow our base of high-margin annual renewable revenue, we believe we are creating an increasingly valuable base that should deliver significant shareholder value.

Overall, I am also pleased we outpaced our 20% annual growth goal in Q1, and look to continue the strong momentum throughout 2022.

With that, I'll turn the conference back to Tracy Clifford, our CFO, to provide insights and review the financials in more detail.

Tracy Clifford
Thanks, Jan. Following that overview, I'll just add a bit more detail about the financials, which are also in our 10-Q filed this morning, and then we'll take questions from investors.

In Q1 ’22, reported GAAP revenue was approximately 3% to $1.75, million reflecting a 9% increase in hardware revenue, and a 2% decrease in monitoring revenue. The increase in hardware revenue is due to more monitoring units sold in Q1 ‘22 versus Q1 ‘21, including True Guard-2, and Hero-2 units. Partially offsetting the increasing units sold was approximately $112,000 in revenue that was recognized in Q1 ’21, from the sale of custom True Guard Pro units that were custom designed for monitoring by the customer, and thus the revenue was not deferred.

Excluding the sale of those custom units, hardware revenue would have been $585,000 in Q1 ‘21. Therefore, the increase in hardware revenue, excluding those custom units, was approximately 30% period-over-period.

Jan mentioned in his opening remarks that the increase in units sold is largely due to the replacement of sunsetting 3G technology units. As new units replace the older units, monitoring revenue does not decrease in line with unit sales, because the new equipment extends the prepaid monitoring plan of sunsetting units. Therefore, sunsetting benefits hardware sales, but does not have the same accretive impact on monitoring revenue.

Also, some customers who choose not to upgrade to newer technology may drop their IT monitoring plans. These factors explain strong hardware revenue in Q1 and weaker monitoring revenue.

We saw similar trends in 2021, particularly as the year progressed. Our gross profit, which grew 4% to $1.3 million in Q1 ‘22, reflecting a gross profit margin of 72% versus 71% in Q1 ‘21. Again, gross margin improved slightly, despite increases in production and manufacturing costs.

As Jan noted, during 2021, we took some specific actions to maintain a strong gross margin, which included implementing the price increase of 15% to 20% last September, and we also negotiated a more favorable cellular data rate plan for our business, effective in March 2021. The new rate structure resulted in an improvement in our gross margin on monitoring, from 86% in Q1 ’21, to 92% in Q1 ‘22.

Total operating expenses increased 17% to $1.4 million in Q1 ‘22, reflecting higher SG&A and R&D expenses versus Q1 ‘21. The increase in SG&A was principally due to increases in personnel expenses, as well as for increased travel, trade show, and corporate expenses. Corporate costs increased primarily due to higher audit and other public company and corporate expenses. R&D increased due to salary increases for our engineering team, which were effective last September, as well as the expenses related to the development of next generation products and potential new product lines. Our consolidated Q1 ’22 operating loss was $122,000, versus operating income of $26,000 in Q1 ‘21, with the difference due to higher operating costs.

In Q1 ‘21, Acorn reported a net loss of $123,000, or zero cents per share, versus net income of $20,000, or zero cents per share in Q1 ‘21. As mentioned, cash basis revenue grew 26% in Q1 ‘22 over Q1 ’21, with continued positive momentum in our business. We believe that the quality of our products and services, our technological innovations, and the strength of the OmniMetrix team will lead to continued growth and market share gains, particularly in the commercial and industrial markets for power generation, as we continue to introduce new solutions, product improvements, and new product lines.

Turning to the cash flow, cash generated from operating activities improved to $221,000 in Q1 ’22, compared to $68,000 in Q1 ’21, primarily due to increased deferred revenue from sales in the current year period. The company invested $57,000 in inventory in Q1 ’22, in addition to inventory investments of $381,000 in physical 2020.

In physical 2021, as part of a continued effort to mitigate procurement issues for key components and materials in the face of global supply chain disruption, inventory increased to $674,000 at March 31, 2022, from $243,000 in March 31, 2020. This investment in inventory is part of the strategy we've been discussing to minimize potential impacts to our business from shortages or long lead times, and delays in obtaining critical components and supplies for our business.

We have the capital and financial strength to reduce business risk through the management of our working cost capital, and our proactive actions have thus far been successful in maintaining strong growth. As we did in the latter half of 2021, in Q1, we continue to invest in our technology and software, with $157,000 invested in the development and design of a new Azure cloud hosting environment to help us achieve rapid deployment scalability and continued innovation as we grow. The Azure environment project was completed and launched on May 2, 2022, and we are very excited about that achievement.

It will also potentially avoid increasing costs as we grow connections, by eliminating vendor hosting fixed-cost contracts in exchange for flexibility and a pay-as-you go arrangement. Our other technological innovation is the design and development of a new user interface for customers to access their data provided by our monitoring service. The new interface is more user-friendly, and in phase two of the development, will offer more functionality and value to our customers, such as self-service custom reporting capabilities. These investments in technology allow us to work more efficiently and cost effectively internally, while also offering our customers a higher level of service, and continue to keep OmniMetrix on the cutting edge of technological innovations in the IoT space.

With respect to our liquidity, we had consolidated operating cash of approximately $1.8 million at quarter end, versus $1.7 million at year end. As of May 11th, our operating cash balance was $1.3 million, which excludes $300,000 we have set aside in an escrow account pertaining to a potential acquisition that we are evaluating within our space.

As our financials reflect, we've been able to maintain liquidity, while also investing for future growth, and we believe we have the financial strength and cash flow to continue to execute this growth strategy successfully.

As we have stated in past calls, in February 2021, we paid off our AR credit line, and thus far, we've elected not to renew it. Should we decide to obtain a new credit line at some point, we believe that we could do so at favorable terms.

Again, we are very pleased with our performance in early 2022, and we're excited about the rest of the year and for the longer term opportunities for our business.

With that, I'll turn the call back to the operator to open it up to Q&A. Thank you very much.

QUESTIONS AND ANSWERS

Operator
Thank you. 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 the roster.

First question comes from Peter Rabover of Artko Capital. Please go ahead.

Peter Rabover
Hi, guys. And I'm sorry, my questions are related to some of the things you said, and I wanted to make sure I heard them correctly. So, the first one is, I think you mentioned that the new hardware sales result in lower moderate revenue uptake than in the past. Did I hear that correctly?

Tracy Clifford
That's correct.

Peter Rabover
I'm sorry. What was the reason that you gave for that?

Tracy Clifford
The reason for that is, with the new monitoring equipment that replaces the 3G technology, those new units are replacement for existing units, and they assumed a prepaid monitoring plan that is still remaining. So, if a customer is replacing a 3G unit and they prepaid for 12 months of monitoring, and they're halfway through that 12 months, there would still be 6 months that would be amortized related to that. So, there's not incremental growth until the next renewal year.

Peter Rabover
Got it. I understand that. And you think this is like a one-time that this year kind of thing, or how long do you think this 3G sunsetting will last?

Tracy Clifford
I think we’ll continue to replace 3G units throughout 2022. We expected, certainly, that AT&T was going to cut off, and the various carriers was going to cut off complete 3G technology in February, but they've continued to allow service in certain areas. So, we'll continue to see replacements, we believe, through the balance of 2022. Outside of that, I don't think we'll have it going into 2023.

Peter Rabover
Okay, but thank you for that color. And then on the last thing, I think you casually said you're evaluating an acquisition. Is there something you can elaborate on, please?

Tracy Clifford
Sure. Jan, do you want to take that?

Jan Loeb
Sure. We are evaluating an acquisition. We are currently in our due diligence process. So, it's a company that very much fits with us. And as we've said, we won't do an acquisition that we don't feel is accretive to our company. That's all I can really say right now. Hopefully, assuming we advance to a definitive agreement, we'll have a lot more to talk about.

Peter Rabover
Okay, great. Thank you so much for the color. I appreciate it. I'll let somebody else get on and ask some questions.

Operator
Thank you. Again, if you have a question, please press star then one. Next question will be from Jack Mayer, private investor. Please go ahead.

Jack Mayer
Good morning. Congratulations on a good quarter [overlapping voices] very, very good quarter. Jan, so Tracy said that the, I guess almost all of the decrease in cash between March 31st and May 11th is due to putting money in an escrow for an acquisition. Did I hear that correctly?

Jan Loeb
That is correct.

Jack Mayer
Can you elaborate on that at all?

Jan Loeb
It's kind of what I said to Peter. It's a unique situation that we were able to move quickly on. And so, we put some money in an escrow account to show our seriousness with the seller. And hopefully, after we continue, after we complete our due diligence, we'll have more to talk about. But right now I can't really talk more about it.

Jack Mayer
Do I understand correctly that if you are satisfied with the due diligence that you are doing, that the seller is in some way obligated to proceed, given that you put money into escrow?

Jan Loeb
Yes.

Jack Mayer
Okay. Thanks for that clarification. Do you expect that the due diligence would go beyond the end of this quarter?

Jan Loeb
No.

Jack Mayer
Okay. Well, again, thanks for that clarification. And I am pleased to know that you're optimistic about the future of the company by having bought stock in April, so, I guess that's good news.

Jan Loeb
You could say that maybe I'm not the greatest investor since I paid $0.50 cents for it and stock is now at $0.40 cents, but, yes, I have a great view of the company. I think the company is really well-positioned, and I thought that that was a great price.

Jack Mayer
Okay. Well, excellent. Thanks very much.

Jan Loeb
Thank you.

CONCLUSION

Operator
This concludes our question and answer session. I'd now like to turn the call back over to Jan Loeb for closing remarks. Please go ahead.

Jan Loeb
Thank you again for your interest in Acorn. We are quite pleased with the performance of our business early in 2022, and we are excited for the rest of the year and for the long-term prospects of our business. We appreciate your support, and I'm happy to speak with investors or prospective investors about the business. You can set up a call with me or ask a question to our Investor Relations, whose contact information is in today's press release.

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

Operator
Conference is now concluded. Thank you for attending today's event. You may now disconnect