Acorn Energy, Inc.

Second Quarter 2022 Earnings Call

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CORPORATE PARTICIPANTS

Jan Loeb - *CEO, Acorn Energy, Inc.*

Tracy Clifford - *CFO, Acorn Energy, Inc &, COO OmniMetrix*

PRESENTATION

Operator
Good morning, and welcome to the Acorn Energy Second Quarter 2022 Conference Call. At this time, all participants are in a listen only mode. After some prepared remarks, we will conduct a question and answer session. 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 all to our conference call this morning. As a reminder, many of the remarks that follow and answers to 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 other risks.

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 revisions to these forward looking statements to reflect events or circumstances occurring 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.

Reconciliations of certain non-GAAP financial metrics to their corresponding GAAP measures are provided in today's press release, which is available at the Investor Relations section of the company's website located at www.acornenergy.com.

I'll now turn the call over to Jan Loeb, Acorn's CEO, for an overview of our business performance and outlook. Jan?

Jan Loeb
Thank you, Tracy. Good morning, and thank you all for joining today's conference call. As many of you know, all of Acorn's revenue comes from our 99% ownership of our operating subsidiary, OmniMetrix. Despite a variety of macro challenges such as inflation, rising interest rates, supply chain, and general economic uncertainty, OmniMetrix's hardware monitoring service model delivered a modest revenue improvement and improved gross margin in both the second quarter and first half of 2022 versus the year ago periods.

Our hardware revenue continues to benefit from the decision by wireless service providers to no longer support legacy 3G wireless technology in favor of newer technologies like LTE and 5G, which delivers superior bandwidth and performance. As we've discussed, this sunsetting of 3G has benefit sales of our next-generation monitoring hardware but has had a nominal negative impact on our monitoring revenue growth. And this is mainly due to the loss of some customers that do not upgrade or renew their monitoring services. We expect a small number of remaining 3G units to be upgraded over the balance of the year, substantially completing this transition.

While we are disappointed with our operating performance in the second quarter, we expect to have a significantly stronger second half returning to what we believe is an attractive sustainable long-term path to growth.

Our positive outlook is based on purchase orders we have received along with current customer dialogues in progress. We are also confident about our longer-term growth prospects, especially in underpenetrated commercial and industrial markets we currently serve as well as opportunities to deploy our industry-leading remote monitoring and control technology and expertise in new complementary applications.

For example, in the second half of last year, we started beta testing, a new solution, our remote A/C Disconnect or gas pipelines, a product we call the RAD. We said our first customer trials will begin in April. And today, I'm very pleased to say that one of the top five global oil and gas companies in the world has given us a significant order for our RAD solution, which we expect to start deploying later this year.

We're also very excited about the significant growth potential we see in the area of electric power grid relief via the use of standby generators in demand response programs. Demand response programs provide compensation to standby generator owners who agreed to support the electric grid in meeting peak power demand by allowing an authorized company such as OmniMetrix to automatically activate their standby generator in times of grid stress, helping to avoid rolling brand-outs or blackouts in their communities.

We believe demand response offers OmniMetrix the potential to substantially increase the value of our business by at least doubling our profit per enrolled generator monitoring endpoint. Demand response programs pay the standby generating owner an annual fee just to make the generator available when needed and an additional fee when the generator is put into service. These programs are available across commercial, industrial, and residential markets, but are only available for the latest generator models that deliver enhanced energy efficiency.

To vision OmniMetrix to take a crucial role in demand response, in June, we partnered with CPower Energy Management, the leading national energy solutions provider. CPower develops demand response programs with each independent system operator, ISO, and OmniMetrix delivers the enabling wireless remote generator monitoring control services to automatically shift the power load to enroll standby generators when the grid is stressed without any action on the part of the generator owner, while also monitoring generator activity and distributing payments.

So the generator owner not only has the peace of mind of knowing that their generator is monitored and therefore, will work when needed from reliable power during extreme weather events, but also consumers will now be compensated for allowing their generators to be on call to potentially avoid power outages for their neighbors in their community through demand response.

This partnership with CPower will also serve as a catalyst for dealers to offer new standby generators on significantly more favorable terms to homeowners and businesses. Not only does it bode well for generator sales, but it also makes the value proposition for acting for remote monitoring more enticing. In other words, if you can get a recurring payment for simply being on standby for a few hours a year, then purchasing or upgrading a generator equipped with remote monitoring capability is an easy economic decision.

Last year, we partnered with Houston-based power solutions specialist, a leading Briggs & Stratton generator dealer in Texas, to bundle our monitoring solutions with generator sales. Building on our relationship, last month Power Solutions became the first dealer to partner with us on demand response. Through this partnership, Texas homeowners can earn compensation for offering good relief to the Texas ISO, the Electric Reliability Council of Texas, known as ERCOT.

With heat waves around the world, stress on the grid has become a hot topic across the U.S., but particularly in Texas, the Midwest, and California. Adding to the grid burden is the rapid growth in electric vehicles. Though still a small percentage of cars and trucks on the road, there are mandates and goals to increase electric vehicle penetration, just as California's commitment to become 100% EV by 2035, and California is already restricting or recommending that EVs only be charged at night.

Given these and other factors, the grid problems of today are expected to grow rapidly in years to come and should create long-term demand for our demand response solutions.

We've talked a bit on recent calls and today's press release about macro challenges that are mostly beyond our control from supply chain disruptions to inflation, rising interest rates, and other general uncertainties in the economy. While we are not immune to these issues, our team has done a great job managing through these challenges.

For example, we've invested in inventory and advanced procurement of critical supplies and we have also made some design adjustments to accommodate parts availability. To address rising input costs late last year, we implemented a 15% to 20% price increase on monitoring equipment. While we are pleased with our current position, we will consider additional inventory pricing adjustments as needed to protect our business position.

With respect to inflation, it can also be a marketing point for our business to potential customers as our solutions reduce the personnel costs, travel time, emissions, and the overall environmental impact required to monitor and manage industrial assets and critical systems.

Our value proposition improves as lease costs increase as remote monitoring a significantly less expensive, more effective and more environmentally friendly than inspection teams driving trucks to remote locations.

Before handing the call to Tracy, I wanted to update you on the potential acquisition we discussed on our last call. We had set aside $300,000 of cash in an escrow account for a potential acquisition that we were evaluating within our space. We had executed a binding letter of intent, had conducted due diligence, obtained non-dilutive financing, and were prepared to move forward. However, the seller's Board had a fiduciary out and chose not to move forward with our deal.

During the second quarter, our escrow deposit was returned in full. We continue to look for attractive acquisition opportunities and are fortunate to have significant financial strength and backing to support our business and its efforts.

Overall, though I'm not pleased with our revenue growth in the first half of 2022, I am pleased with the progress we've made in business development and with our outlook for the second half of 2022.

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

Tracy Clifford
Thanks, Jan. I'll provide a brief overview of our financials in today's release and our 10-K filed this morning. Then we'll open the call for your questions.

Our second quarter revenue rose approximately 1% to $1.62 million, reflecting a 10% increase in hardware revenue and a 5% decrease in monitoring revenue. As Jan noted, the increase in hardware revenue was primarily due to sales of next-generation monitoring equipment to replace legacy 3G devices related to the sunsetting of 3G technology by wireless carriers.

Also pursuant to GAAP since we defer and amortize hardware revenue over three years, revenue trends are indeed impacted by sales in prior quarters. Conversely, sunsetting has negatively impacted our monitoring revenue to some degree as the legacy 3G units replaced with next-generation technology assumed a prepaid monitoring plan of the older unit. So while hardware revenue increases with the new equipment purchase, there's no growth impact on monitoring revenue.

Also, some customers inevitably choose not to upgrade to newer technology when their 3G unit went dark and thus their monitoring service was terminated. The first half of 2022 reflects this sunsetting impact as hardware revenue grew 10%, while monitoring revenue fell 3%. We expect to see the negative impact of sunsetting on monitoring growth to be largely behind us by year-end as just a small percentage of 3G units remain in the field.

Our gross profit grew 2% to $1.25 million in Q2 '22, primarily reflecting revenue growth and gross margin improvement to 77% from 76%. Note that our gross profit and gross margin improved slightly despite increases in production and manufacturing costs.

Last year, we took some specific actions to maintain margin, including a price increase and the negotiation of more favorable cellular data rates for our business, and we continue to look for opportunities to enhance gross margin as we grow the company by offering more services such as installation and customer reporting.

Total operating expenses increased to $1.47 million in Q2 2022, reflecting higher SG&A and R&D expenses versus Q2 '21. R&D increased by $37,000 over Q2 '21, primarily due to salary increases for our engineering team effective last September in addition to continued development of next-generation remote monitoring and control products and the exploration of potential new product lines.

SG&A increased by $163,000 over Q2 '21, mainly due to increases in personnel expenses, increased travel, trade show and corporate expenses, and technology consulting fees. In the second quarter of 2022, we also recorded an impairment charge of $51,000 related to an investment in ERP software that we elected not to implement.

Our consolidated Q2 '22 operating loss was $222,000 versus operating income of $5,000 in Q2 '21, with the difference due to the decline in revenue and higher operating costs as discussed. Acorn reported a Q2 '22 net loss of $223,000 or $0.01 per share versus net income of $2,000 or $0.00 per share in Q2 '21. For the first 6 months of 2022, the net loss was $346,000 or $0.01 per share as compared to the net income of $22,000 or $0.00 per share in the first 6 months of 2021.

As reflected in our release, cash basis revenue grew 5% over the first 6 months of 2022, despite falling 15% in Q2. We think the weakness in Q2 was largely due to consumer uncertainty created by the rapid rise in interest rates, energy prices, and market volatility as well as sales being executed earlier in the year during the first quarter when our cash sales grew 26%.

Looking at cash flow, cash used in operating activities was $194,000 in the first 6 months of 2022 compared to cash generated of $83,000 in the first 6 months of 2021, primarily related to investments in working capital, including inventory purchases and accounts receivable.

Acorn invested $298,000 in inventory in the first half of 2022 to avoid delays in procuring critical components and materials. In the current environment where supply chain disruptions remain a global concern, we believe that this is a prudent investment in our business and our growth since we have the financial strength to do so.

Thus far, through proactive inventory management, we have avoided any significant negative impacts or delays in our ability to deliver products, and we feel we are well positioned going forward.

During the first half of 2022, we also continued to invest in our technology and software, including $266,000 for the development and design of a new Azure cloud hosting environment for our monitoring solutions, as well as investments in hardware and software upgrades. Our new cloud server environment will help us in achieving rapid product deployment, enhanced scalability, and better support continued innovation as we grow.

The Azure project was completed and launched during Q2. It will also allow us to avoid higher costs as we grow monitoring connections by eliminating fixed cost, vendor hosting contracts in exchange of the flexibility of a variable pay-as-you-go arrangement.

Another technology initiative we are very focused on is the design and development of a new user interface for customers to access their monitoring data. This interface will be much more user-friendly and incorporates customer feedback to enhance the user experience. We expect to launch the new interface in beta test mode to a group of customers for field testing by the end of the third quarter with a full customer launch expected by year-end.

We will then commence Phase 2 of the user interface development that is intended to provide greater functionality and value to our customers, such as custom self-service reporting capabilities. We believe our technology investments keep up on the metrics on the cutting edge of technological innovation in the industrial IoT space.

With respect to our financial position, Acorn remains in a solid position with a consolidated cash balance of approximately $1.1 million as of August 9. This includes the return of the $300,000 escrow deposit that Jan mentioned for the potential acquisition that we were evaluating within our space. Our escrow was returned, as Jan noted, when the other party elected not to move forward with the sale.

As our financials reflect, we've been able to maintain a healthy liquidity position while also investing for future growth, and we believe we have the financial strength and expected cash flow to continue executing on our growth strategy.

In summary, although our gross revenue growth rate in the first half of 2022 did not meet our expectations, we're encouraged by the indicators for our growth potential in the second half of 2022 and going forward.

With that, I'll turn the call back over to the operator to take investor questions. Thank you for your time.

QUESTION AND ANSWER

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

And again, if you have a question, please press star then one.

Our first question here will be from Edward Gilmore, a private investor. Please go ahead.

Edward Gilmore
Thank you. Hi, Jan. Good morning. And congrats on the new partnership with the oil and gas partner. I was just wondering if you expect to put a press release out about that with any more information? Or is there any other additional details that you might be able to share today on the call?

Jan Loeb
Firstly, good morning and thank you very much. No, not right now. And there's probably a couple of reasons why I wouldn't want to do it right this second and that is I certainly would need to have signoff from the oil and gas company, number one. Number two is this is -- this would be our first

customer in a brand-new product in the space. So I'm not sure I want to give my competitors kind of a path. I'd rather maybe rack up a couple of more big customers before we have a big press release or a big splash about it. So my gut right now is, unless it turns out to be like a super material event that we would not put out a press release.

Edward Gilmore
Okay. Thank you. And then you sound pretty upbeat on the back half of '22 here and it seems pretty promising with what's in the pipeline. I wondered if maybe you could elaborate a little bit on that and maybe what you attribute that upcoming strength, too?

Jan Loeb
I am positive about the second half of the year. And some of it is, as you just mentioned, the RAD; so we have some new product coming out in the second half of the year. We have a couple of customers, bigger customers, that the sales cycle takes longer. And so we've been working on them for a bunch of months and so it looks like in the second half of the year, they'll actually come through. As you can tell from Power Now, our deals with Power Now, which is a Briggs & Stratton dealer, we are putting more focus on Briggs & Stratton dealers than we've had in the past. So just a combination of reasons gives me confidence that we should have a much better second half than we had in the first half.

Edward Gilmore
Okay. Great. And one last quick question. I know you've been pretty active in the past in purchasing on open market shares of the company. And I know as a private investor, I appreciate that other investors appreciate that. I was just curious if you had any plans to continue that this year. And I'll jump off. Thank you.

Jan Loeb
I have -- it's opportunistic. It's not like I have a master plan. And I'm sure other investors appreciate it. That's not why I'm buying it. I'm buying it because I think I can make some significant money on my share purchases. So I don't want everybody to believe that it's my altruism that's doing it. Thanks a lot, Ed.

Edward Gilmore
Thank you.

Operator
Again, if you have a question, you may press star then one.

And we have a question from Jack Mayer from Family Trust. Please go ahead.

Jack Mayer
Hi, Jan. Congrats on the progress. Just very briefly, you've talked about these new things with the power offloading -- I'm sorry.

Jan Loeb
You're talking about demand response?

Jack Mayer
Right. The demand response, and you've indicated when you thought that that would begin to matter to the bottom line. Question is, are there any metrics that you think you're going to be able to refer to before you actually start making money on this that will give us some indication of how that's going?

Jan Loeb
I don't believe that the company will give out metrics, but I think what you should be able to discern is profit margin expansion. So what will happen is demand response is a highly profitable piece of business because we don't sell any products. We don't have any COGS associated with it. We have a little bit of SG&A, but not much in way of SG&A. So when you should start to see, as this begins, and it's going to begin slowly, it's not going to all come overnight, it's going to ramp and build slowly. But as you see profit margin expansion, it will most likely be due in large part to demand response.

Jack Mayer
Got it. And so based on your current expectations, at what point do you think that that will begin to be material -- the change -- at what point do you think the change will be recognizably material?

Jan Loeb
I don't know the answer to that. But what we've said is that it will start in 2023, meaning the dealers that we're talking to, they have to deploy the machines. The machines have to be signed up with the ISOs. So we're saying that it should start in 2023. But as I said, it's going to ramp, and I can't tell you when it will start to show meaningful numbers.

Jack Mayer
Got it. Okay.

Jan Loeb
Thank you.

CONCLUSION

Operator
With no remaining questions, we will conclude the question and answer session. At this time, I would like to turn the call back over to Mr. Jan Loeb for any closing remarks.

Jan Loeb
Thank you again for your interest in Acorn Energy. We are very excited about the opportunities in front of us and for the long-term prospects of our business. We appreciate your support, and I'm always happy to speak with investors or prospective investors. You can set up a call with me or ask any questions through our Investor Relations team or through Tracy Clifford, whose contact information is in today's press release. Otherwise, we look forward to updating investors on our Q3 conference call. Thank you again. I believe that concludes today's conference call.

Operator

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