Acorn Energy

Fourth Quarter 2022

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CORPORATE PARTICIPANTS

Tracy Clifford – Chief *Financial Officer of Acorn Energy and Chief Operating Officer of OmniMetrix*

Jan Loeb – *Chief Executive Officer of Acorn Energy and OmniMetrix*

PRESENTATION

Operator
Good morning, and welcome to the Acorn Energy Fourth Quarter and Year-End 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 OmniMetrix. Ms. Clifford, please begin.

Tracy Clifford
Thank you. We welcome, everyone, to today's call. As a reminder, many of the remarks that follow and answers to 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 2022 and future years is subject to risks associated with disruptions to business operations and customer demand resulting from the company executing its operating strategy, maintaining high customer renewal rates and growing its customer base as well as from changes in technology, changes in the competitive landscape and changes in the financial and economic environment.

Forward-looking statements are based on management's beliefs and the assumptions made using information currently available to the safe harbor provision of the Private Securities Litigation Reform Act of 1995. There are no assurances that Acorn or OmniMetrix will be able to achieve management's growth goals in 2023 or future periods, and the company undertakes no obligation to disclose revisions to such 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 our 10-K under Risk Factors as filed with the Securities and Exchange Commission. A reconciliation of certain non-GAAP financial metrics to corresponding GAAP measures is provided in today's press release, available in the Investor Relations section of the company's website, acornenergy.com.

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

Jan Loeb
Thanks, Tracy. Good morning and thank you all for joining our call today. Two thousand and twenty-two was another year of growth for Acorn, albeit at a slower rate than we forecasted and would expect to see in the future. The fact that we did achieve growth in 2022 is a testament to the resilient business of our operating subsidiary, OmniMetrix, and its monitoring service model. Considering macroeconomic headwinds as well as industry challenges due to sunsetting of 3G technology, I think we navigated the challenging landscape in a formidable manner. So in light of this, I'd like to congratulate the entire OmniMetrix team, including management, our knowledgeable sales and technology teams, our innovative engineers, tech support and production and our back-office folks who work together to be successful and are truly our greatest asset.

When I talk macro headwinds, which are things we do not control, one example that people may or may not realize is how rapidly rising interest rates impact our business. The Power Generation segment is our largest segment that is the monitoring and control of generators. The vast majority of new generators are purchased on credit, especially in the residential market, and to some degree in the commercial and industrial or C&I market. So obviously, any increase in the borrowing rate for consumers or business can have a negative impact on the number of new generators sold. We don't sell generators, but sales of monitoring equipment, and our monitoring services are directly tied to sales of new power generators, so it has an impact on the demand for our products and services.

While single-digit revenue growth is obviously well below our growth target of 20%, all things considered demonstrating any revenue growth in a difficult environment is still a favorable outcome. In 2022, wireless carriers stopped supporting 3G technology, so anyone who had older monitoring equipment had to make a decision on whether to upgrade their monitor to LTE, simply let their monitoring contract expire or go to a competitor's device. As a result, we had some customer churn in 2022, which depressed our growth, particularly of high-margin monitoring revenue. The good news is that this sunsetting of 3G technology is behind us, and we expect to return to a stronger growth trend in 2023.

As we note, each quarter generally accepted accounting principles or GAAP requires us to defer our hardware sales over three years and amortize it monthly into revenue. And for monitoring, we defer revenue and amortize it monthly over the term of the monitoring contract, which is typically one year. The cash value of the sale, however, is invoiced at the time of the sale and collected within normal pay terms of 30 to 90 days.

When we refer to our growth rate, we measure this on a cash basis of revenue and we provide a reconciliation of cash basis revenue to GAAP revenue in our quarterly press release, as we have done today. In 2022, our monitoring revenue declined approximately 3% due to 3G-related customer churn. But as you can see in Q4, it was flat, and we expect a return to monitoring revenue growth in 2023. Hardware grew approximately 17% in 2022, adjusting to exclude nonrecurring sales of custom units in 2021. The growth rate was 13% with the inclusion of the nonrecurring sales in 2021.

In 2023, we expect a return to more normal growth trends, which we benchmark as 20%. Some of the reasons for our optimism are based on what we are seeing in Q1 in terms of sales discussions, forecasts and orders from current customers and new business leads. We have a solid and growing base of high-margin commercial and industrial customers, which we expect to be the foundation of our strong revenue growth in 2023.

Our new remote AC mitigation disconnect solution for gas pipelines, which we call RAD, is continuing with customer trials, and we have some new customer prospects. We are pleased with the progress of the trials, and we are bullish on the prospects for orders in 2023. In prior calls, we have discussed our new demand response program. With demand response, our monitoring and control technology is used to enable standby generators to be automatically turned on to provide electric power grid relief during periods of extreme demand for up to 12 hours per year. This helps grid operators call independent system operators, or ISOs to avoid rolling brownouts or blackouts. Demand response programs compensate generator owners simply for enrolling in the program, and OmniMetrix earn fees for enabling and managing the generator endpoint. We believe these programs offer the potential to substantially increase the value of our monitoring franchise by approximately doubling our profit per enrolled generator. Demand response programs are available across commercial, industrial and residential markets for new generators that deliver enhanced energy efficiency.

In 2022, we partnered with CPower Energy, the leading national energy solutions provider. The partnership allows us to offer demand response solutions to generator dealers. We signed our first dealer, Texas-based Power Solutions, in the second half of 2022, to allow homeowners to earn compensation for offering grid relief in Texas to ERCOT customers. The Electric Reliability Council of Texas, or ERCOT, manages power for 26 million customers. This week at the Electrical Generating Systems Association, or EGSA, industry Show in Las Vegas, CPower exhibited with us in our booth.

In addition to some of these specific examples, there are several longer-term trends that will continue to benefit our business. First, the electric grid is a major concern in the United States. Due to the age of the infrastructure and to a lack of investment in new power supplies, outside of wind and solar power projects, and wind and solar are intermittent by nature, stress on an aging grid is not going to be solved anytime soon, as it takes more than a decade of planning to build a new power plant in this country. With the growth of electric vehicle market, which is supported and subsidized by the government, electricity demand is only going to increase in the coming decade. The increase of severe weather events is also likely to continue, thereby further increasing demand for standby power generation and for microgrids throughout the economy. All these overriding factors create a scenario of increasing long-term demand for grid relief and for demand response programs provided by standby generators.

I've talked about how inflation has an impact on our cost, but conversely, it can also have a benefit in terms of our business and our value proposition. This is because our monitoring solutions reduce personnel costs, travel time, emissions and overall environmental impact required to maintain industrial equipment and critical systems. Therefore, as our customers' cost increase, the return on investment of our services to them also improves.

Remote monitoring will always be a significantly less expensive alternative than physical inspection, particularly with higher personnel and fuel costs. Our solutions also provide customers with essential data and information that enables them to improve their internal operations by making timely decisions and avoiding costly equipment malfunctions. Remote monitoring and control of equipment leads to improved efficiency, better maintenance, and reduced downtime of critical equipment. Cost savings is always important to customers but cost-effective solutions are even more essential in an inflationary environment.

Again while our growth has lagged, the rate we believe is achievable over the longer term and I'm pleased with our team's success in navigating challenges in 2022, and we see significant near-term opportunities in 2023. That is why we continue to invest in our business, in our products and services and our IT infrastructure to enhance our competitive position. We will continue to be opportunistic in evaluating acquisitions, of which I would like to accomplish at least one this year. I believe private company owners have become more realistic about their company's value in this market environment. We have more than $70 million of operating loss carryforwards, which could be useful if we were to acquire a profitable business and also as we organically achieve profitability.

Before turning the call over, I want to mention that we intend to add a new board member in the coming days. This will increase the board size by one, adding an independent board member who has strong familiarity with Acorn, is financially savvy and hopefully bring new and constructive ideas to the company.

Now I'll hand the call over to Tracy Clifford, our CFO and CEO of OmniMetrix to review our performance and to provide additional insights. Tracy?

Tracy Clifford
Thanks, Jan. First, let me note that we filed our 10-K this morning with the SEC, for your reference. And now let me provide some additional detail and comments on our reported results, and then I'll turn it over to the operator for investor questions.

Looking at the year as a whole, our reported revenue, as Jan noted, rose 3% to $7 million in 2022 from $6.8 million in 2021, which was driven by an increase in revenue from hardware and accessories. Excluding some one-time customer orders that we had in 2021, hardware revenue growth would have been 17% in 2022. The increase was largely due to a higher percentage of commercial and industrial, what we call C&I product sales, which carry higher average price points.

In 2022, we focused our Power Generation customer expansion on large C&I customers, and we're continuing that strategy in 2023. Hardware sales also benefited from the sunsetting of older units, but with new units largely replacing older units and due to some churn, as Jan noted, monitoring revenue did not increase ratably with hardware revenue. As such, annual recurring revenue, or ARR, was 56% in 2022 versus 60% in 2021.

Looking at Q4, our quarterly revenue increased 5% to $1.85 million from $1.75 million in Q4 '21, with hardware growing 12%, while monitoring was essentially flat. We feel that monitoring revenue stabilizing is a good signal after several quarters that lagged compared to the same quarter in the prior year. We're glad that the impact of sunsetting is largely behind us, and we can focus on continuing to grow our C&I customer base and pursuing a return to the double-digit revenue growth of high-margin monitoring revenue in 2023.

From a margin perspective, our gross profit grew to $5.1 million in 2022, reflecting a 72.4% margin compared to 72.3% in 2021. Gross margin on hardware improved to 48% in 2022 versus 44% in 2021, reflecting a more favorable product mix. Our overall gross margin was particularly strong in Q4 at 73.3% versus 69.8%, again benefiting from sales of higher-margin C&I products. In Q4, our ARR was 54% of total revenue. In 2023, we will continue to look for opportunities to maintain and further increase gross margin and revenue as well as to gain market share by offering additional services such as monitor installations and also value-added enhancements like customer reporting features in our product updates.

Looking below the gross profit line, total operating expenses, including Acorn's overhead, increased to $5.7 million in 2022 versus $4.9 million in 2021 due to increased SG&A expenses and more research and development costs. We, like many companies, faced higher costs in 2022, particularly personnel costs, which increased $248,000 due to added roles, market rate increases, bonuses and increases in the cost of benefits. Two thousand twenty-two SG&A also included a software impairment of $51,000 for an ERP software customization product that was evaluated and terminated. It also included $45,000 in increased depreciation expenses as a result of the launch of our new Azure environment in May 2022, which is when the depreciation on this project commenced. I'd like to direct you to our earnings release on our website that we filed this morning, in which I provided some additional detail on our SG&A expenses as well.

Our R&D expenses increased by $106,000 on the continued development of enhanced products and for the exploration of potential new product lines. Despite higher costs, we will continue to fund innovation, which is one of the keys to our growth and success as a company and allows us to maintain a competitive edge over many of the competitors in our space.

As it relates to our results attributable to Acorn shareholders, we reported a net loss of $633,000 or $0.02 per share for the full year 2022 versus a net loss of $21,000 or $0.00 per share in '21. In Q4, the net loss attributable to Acorn shareholders was $77,000 compared to a net loss of $66,000 in 4Q '21.

Looking at our cash flow. Cash provided by operating activities was $31,000 in the 2022 period compared to $132,000 in the '21 period. We had strong receivable collections and less inventory investment in 2022, partially offsetting the net loss. In 2021, we had implemented advanced procurement of critical components to guard against supply chain issues, so essentially, we've been carrying excess inventory. On our last call, we said that we intended to reduce our safety stock inventory and return to more normal inventory levels as the supply chain improves. In Q4, we slightly reduced our inventory, but we'll continue to carefully execute on the plan to reduce safety stock, as we always want to be prepared to fill large volume orders that come in from time to time from our C&I customers without having to cannibalize routine par orders from our residential dealers. We do continue to currently maintain some excess inventory, and we'll continue to monitor the situation, including inventory levels needed for growth.

We also continued to invest in technology in 2022, with $292,000, primarily for the development and design of the new Microsoft Azure cloud hosting environment for Omni's monitoring solutions and also for certain hardware and software upgrades. The new cloud environment provides a modern, agile platform to scale our IoT connections. It also lowers our cost by eliminating fixed cost hosting in exchange for a variable rate as we grow. As I noted, the new cloud environment was completed and launched in May of 2022. We're also investing in the design and development of a new customer interface for viewing our monitoring data. The new interface, referred to as OmniView 2.0, will provide a significantly improved user experience. We plan to launch the new interface in the second half of 2023.

Additionally, we will continue to invest in people and technology in 2023 to further improve Omni's leading position in terms of our capabilities, value proposition and customer satisfaction. We're currently recruiting for a West Coast sales representative, which we hope to have hired by the end of April, as we believe this area is a largely untapped market for our remote monitoring solutions.

We're also excited about our recent hire of a new Director of Technology and Software Development in February. This individual has a deep and broad skill set and is very knowledgeable on Microsoft Azure as well. He's already had a positive impact on our strategic plan for 2023, and we feel confident that his addition to our management team will give us even more wins in the competitive arena as he continues to build out our systems and capabilities to exceed customer expectations.

Looking at our financial position as of March 14, 2022, Acorn had consolidated cash balance of $1.48 million with no outstanding debt. We believe we have the liquidity, financial strength and cash flow to continue executing our growth strategy in 2023 and beyond.

In our press release, we reconcile cash basis revenue to GAAP revenue. Cash basis revenue grew 2% to $7.8 million in 2022 as compared to $7.6 million in 2021.

I'll conclude my remarks by reiterating what Jan noted that we believe Acorn is capable of achieving our cash revenue growth target of 20% in the coming year as we continue to execute on our strategic plan.

Thank you, everyone, and I'm going to turn the call back over to the conference operator for Q&A.

QUESTIONS AND ANSWERS

Operator
Thank you. All participants are currently in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. 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 our roster.

Again, to ask a question, that's star one. There are no questions in the queue. This concludes our question and answer session. I will turn the call back over to—excuse me, let me re-prompt one more time. Again, if you have a question please press star then one. That's star then one if you have a question.

At this time, I will turn the call back over to Mr. Jan Loeb for closing remarks.

CONCLUSION

Jan Loeb
Well, I guess that our comments were very all-encompassing, so hopefully we've answered anyone's questions. But we thank everybody for your interest in Acorn Energy. We continue to be excited about the progress and the investments we have made in the company, and we are very excited about the opportunities we see in the IoT space and the prospects of the business.

We appreciate your support, and I'm more than happy to speak with investors or prospective investors. You can also set up a call with Tracy or myself, or ask a question through our IR team whose contact information is in today's press release. Tracy and I look forward to updating investors on our Q1 conference call in May. Thank you all again. Have a great day.

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