Acorn Energy

First Quarter 2023 Earnings

Thursday, May 11, 2023 - 11 a.m.

CORPORATE PARTICIPANTS

Tracy Clifford - *Chief Financial Officer; COO - OmniMetrix*

Jan Loeb - *Chief Executive Officer*

PRESENTATION

Operator
Good morning, and welcome to the Acorn Energy 2023 First Quarter 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 will now turn the call over to Tracy Clifford, CFO of Acorn Energy and COO of its OmniMetrix operating subsidiary. Ms. Clifford, you may begin.

Tracy Clifford
Thank you. 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 2023, 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 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 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 non-GAAP financial metrics to correspond to GAAP measures is provided in today's press release, available in the Investor Relations section of the company's website at acornenergy.com.

I'll now turn the call over to Jan Loeb, CEO of Acorn and our OmniMetrix operating subsidiary. Jan?

Jan Loeb
Thank you, Tracy. Good morning and thank you all for joining our call. It's been less than two months since our Q4 call, so I'll keep my comments brief and leave plenty of time for your questions. We are pleased to report that our monitoring revenue returned to growth in Q1 2023, following negative, year-over-year comparisons in 2022, principally due to the impact of the sunsetting of 3G wireless technology.

With the transition behind us, Q1 2023 margin revenue grew modestly over Q1 2022, providing the first quarter of year-over-year growth since Q4 2021. As we've mentioned in the past, the wireless provider sunsetting of legacy, 3G wireless technology required our customers to upgrade to next-generation, LTE wireless systems. This wireless network upgrade drove an increase in replacement sales of new, remote monitoring equipment in 2022. However, it also had a negative impact on our base of monitoring endpoints, as a small percentage of customers either chose to not upgrade, and thus let their annual monitoring service lapse, or they switched to a competitor's product, such as an OEM solution.

Due to this cycle, our Q1 2023 hardware revenue decreased 4.7%, compared to Q1 2022. Reflecting the offsetting impacts on hardware and monitoring, Acorn's total revenue was flat at $1.75 million in Q1 2023. Note that monitoring revenue gross margins are approximately double those on hardware. Also, we consider monitoring revenues to be annual, recurring revenues, or ARRs, because setting aside unusual events, such as sunsetting, typically, over 90% of monitoring service plans renew upon expiration.

The return to monitoring ARR growth, with its high profitability, enabled us to trim our Q1 2023 net loss to $85,000, from a net loss of $123,000 a year ago. Given these trends and our high gross margin contribution, we believe Acorn is on a trajectory to achieve profitability based on our growth goals. Speaking on a cash basis, historically, our first quarter tends to be the slowest quarter, with business building into Q2, followed by Q3 as the strongest quarter, and Q4 being our second strongest quarter.

2022 was an anomaly to this pattern, as hardware sales were higher than normal in Q1 2022, due to the positive impact of sunsetting units, as previously discussed. So rather than our weakest quarter, Q1 2022 was a very strong quarter, in terms of cash basis revenue, and why cash basis sales were down 9.9% in Q1 2023. We do expect this year to return to a more normal pattern, with Q1 likely our weakest quarter and sales building in Q2 and Q3.

We continue to be optimistic that our business can achieve 20% annual cash basis revenue growth in 2023. If we are able to meet our growth goals, we'd expect to achieve positive cash flow enabling us to cover corporate overhead and achieve profitability on a consolidated basis.
Also, it is important to note, as we have on prior conference calls, that Acorn has over $70 million of net operating loss carryforwards that would largely shield future profitability from tax liabilities, and therefore, benefit our cash flow as we become profitable.

Our confidence in achieving our annual growth goal is based on the business trends we have seen, to date, in 2023, in terms of sales discussions, forecasts and new business leads, including customer field testing activity and a few sizable potential opportunities. We also believe our business will benefit from the increasing focus on environmental issues, including severe weather patterns, as well as business benefits of our industry-leading solutions. We have a solid and growing base of high-margin, commercial and industrial customers, which we expect to be the foundation of our growth in 2023.

Commercial and industrial companies face many challenges, including rising labor and fuel costs, increasing environmental pressures, budget constraints, and ROI goals. OmniMetrix solutions can have a positive impact across all these areas, for a broad array of businesses.
Increasingly, customers are attracted to the reduced carbon footprint of remote monitoring, as they see opportunities to minimize their environmental impact. We believe this trend, combined with our compelling ROI, will support our business development efforts and growth, moving forward.

One solution that we're really optimistic for in 2023 is our Remote A/C Mitigation Disconnect solution for gas pipelines, that we call RAD. Pipeline operates and installed devices to protect their assets from A/C voltage created by overhead power lines. These voltages increase the risk of corrosion. The existing devices also have a need to be periodically disconnected and reconnected, which is done by hand. This requires additional manpower and many hours to complete.

Our RAD product connects via cellular or satellite networks and is used to remotely disconnect and reconnect these devices. This eliminates the need for this to be done manually, as well as ensuring the existing devices are functioning properly. The RAD reduces company expenditures, while dramatically increasing employee safety and being environmentally friendly by saving truck trips. Our RAD solution went into customer trials in late 2022, and we hope to convert some of these trials into orders later this year.

We also hope to see initial customer activity in 2023 for our demand response program, in partnership with CPower Energy. The program compensates generator owners for making their generator available to curtail energy loads when called upon by a participating grid operator. OmniMetrix provides the enabling technology for demand response, and it allows standby generators to be automatically turned on to provide electric grid relief during periods of extreme demand.

This added power supply is thus designed to help grid operators avoid rolling brownouts or blackouts. Standby generator demand response programs are available for C&I and residential customers that have deployed new, enhanced, energy efficient generators. We expect to see these programs begin in 2023, with initial deployments, and then grow in the coming years. Importantly, we expect the added value of our monitoring and control solutions for demand response to deliver roughly twice the profitability of our traditional monitoring endpoints.

In addition to near-term opportunities in 2023, secular trends should continue to benefit our business, longer-term. An aging power grid, lack of investment in new power supplies, growth of electric vehicles and other corporate electrification strategies will put further stress on the grid, as well as increasing prevalence of severe weather events, all of which increase the benefits of standby power generation with remote monitoring control.

Acorn closed Q1 2023 with $1.3 million of cash, no debt, and a business that is approaching positive operating cash flow. We believe we are very well positioned to fund organic growth and to pursue potential external opportunities. We continue to evaluate potential bolt-on opportunities. Fortunately, or unfortunately, public and private evaluations have come down, and we do have the flexibility to be opportunistic for deals in our space that would be accretive to our business and benefit our shareholders.

Finally, in the past, I have said that we were looking to hire a West Coast sales manager, which we recently did, and who starts next week. We feel he has the background to help jumpstart our efforts on the west coast, a large and growing market for backup power generation. Also, in March we added a new Director to our Board, long-time shareholder, Peter Rabover of Artko Capital. Peter is a committed shareholder, and we are confident Acorn will benefit from his experience and leadership.

With that, I'll pass the call back to Tracy for her review of the financials and insights on our operations. Tracy?

Tracy Clifford
Thanks, Jan. I wanted to note that we filed our 10-K this morning. I'll run through some key elements related to our reported results, and then we can turn it back to the operator for any investor question. In the remarks that follow, I'll compare Q1 of this year to Q1 of last year for income statement items. And for balance sheet items will generally compare March 31, 2023, to December 31, 2022. Also, the numbers I discuss are consolidated, and on a GAAP basis, except

for cash basis revenue, which as Jan mentioned, is reconciled to GAAP revenue in today's press release.

Q1 '23 reported revenue was flat, versus Q1 2022, at approximately $1.75 million in each period. Our primary wireless provider, AT&T, stopped supporting 3D wireless units in February of 2022, impacting the prior year period, as Jan previously noted. Notably, Q1 2022 hardware revenue and cash basis revenue were higher than they otherwise would've been, creating less than favorable top-line comparisons in Q1 '23.

Hardware revenue was down 4.7%, and cash basis revenue was down 9.9%. However, on a more favorable note, with the impact of sunsetting now concluded, our higher margin and recurring monitoring revenue returned to year-over-year growth. Given a higher percentage of high margin monitoring revenue in our mix, our Q1 '23 gross profit margin increased to 75.2% of sales, compared to 71.8% in Q1 2022, enabling us to generate $48,000 of additional gross profit.

Total operating expenses increased 2.2%, or $31,000 in Q1 2023, reflecting a 1% increase in SG&A expense and an 8% increase in research and development expenses. The nominal increase in SG&A expense was due in part to the timing of audit fees incurred at the corporate level, which were higher this year compared to prior year period, in addition to a decrease in consulting fees.

We do expect SG&A to increase in the remainder of 2023, due to increased personnel costs from staff additions. R&D expense increased mainly due to Q4 2022 salary increases for our engineering team, and the continued development of next generation monitoring and control products, and for the exploration of new product lines. We believe we have the best technology and products in the industry, due to the quality of the OmniMetrix team and innovative culture. This has allowed us to grow our market share, particularly in the commercial and industrial segment, where we continue to introduce new solutions.

Net loss attributable to stockholders improved to $85,000, versus a loss of $123,000 in Q1 '22, as growth in gross profit outpaced operating costs. On a per share basis, our net loss was zero cents per share in both periods. Turning to cash flow, the company used $83,000 of cash in operating activities in Q1 '23, primarily due to our net loss, and we used $26,000 in investing activities for minor hardware and software technology upgrades. We continue to invest in the development of a new monitoring data customer interface, called OmniView 2.0, which is planned for launch later this year.

In terms of our balance sheet, inventory increased $804,000, from $789,000 at year-end, and $674,000 at March 31, 2022. We're still maintaining some excess inventory to mitigate potential delays in product delivery to fulfill large-volume orders and to strategically support expected growth. With respect to liquidity, we had consolidated cash of $1.3 million at quarter end, and $1.5 million as of May 9.

We believe our balance sheet provides solid support to continue executing on our growth strategy. As many of you know, in accordance with GAAP, we record approximately 90% of our hardware sales as deferred revenue, and then amortize it ratably into revenue over a three-year period. Similarly, we defer monitoring revenue and amortize it over the term of the monitoring plan, which is typically one-year.

The cash value of hardware and monitoring services, however, are invoiced at the time of the sale and collected on normal payment terms of 30 to 90 days. This accounting creates a backlog of deferred revenue, and we want to point out that we ended Q1 ‘23 with a record backlog of $6.2 million, versus $5.7 million in Q1 ‘22. We expect approximately two-thirds of this to be recognized as GAAP revenue in 2023.

Overall, we are very excited for the rest of the year and for longer-term opportunities in our business, particularly in an underserved, commercial and industrial markets for remote monitoring and control solutions, and I look forward to updating you on our progress in the future. Thank you, everyone, for joining the call. And now we'll open the conference call for investor questions. Operator?

QUESTION AND ANSWER

Operator
Thank you. We will now begin our question-and-answer session. To ask a question, you may press *, then 1, on your touchtone phone. If you’re using a speaker phone, please pick up your handset before pressing the keys. To withdraw your question, please press *, then 2. And, at this time, we will pause, momentarily, to assemble our roster. And again if you would like to ask a question, please press *, then 1. As I'm showing no questions at this time, this concludes our question-and-answer session.

I would like to turn the conference back over to Jan Loeb for any closing remarks.

Jan Loeb
Thank you, everyone, for your interest in Acorn Energy. We appreciate your support, and I'm happy to speak with investors or prospective investors or anybody who didn't want to ask a question on the call -- can certainly call us. You can 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 Q2 conference call in August. Thank you again, and this concludes today's call.

CONCLUSION

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