Acorn Energy, Inc.

Second Quarter 2023 Conference Call

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CORPORATE PARTICIPANTS

Tracy Clifford– *CFO and COO, OmniMetrix*

Jan Loeb – *CEO*

Bill Jones – *IR*

PRESENTATION

Operator
Good morning, and welcome to the Acorn Energy 2023 Second 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 conference over to Tracy Clifford, CFO of Acorn Energy and COO of OmniMetrix, its operating subsidiary. Ms. Clifford, please begin.

Tracy Clifford
Thank you and welcome, everyone, to today's call. As a reminder, many of the remarks that follow and answers to questions may be forward-looking. Such 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, from the company executing its operating strategy, maintaining high customer renewal rates and growing its customer base as well as from changes in technology, the competitive landscape, and the financial and economic environment.

Forward-looking statements are based on management's beliefs and the assumptions made using information currently available information 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 in future periods. 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 risks and uncertainties that may affect the company is included in our 10-K under risk factors as filed with the SEC. A reconciliation of non-GAAP financial metrics to corresponding GAAP measures is provided in today's press release and 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, everyone, for taking time and joining this call, today.

Acorn achieved excellent topline growth, consolidated profitability, and positive cash flow in the second quarter. It was our second consecutive quarter of monitoring revenue growth, which is important because it demonstrates that we have returned to a monitoring growth trend following the negative impact of wireless carriers sunsetting their support for 3G monitoring technology.

Monitoring revenues grew 10% in the second quarter, building on a 3% growth in the first quarter. We expect this trend to continue over the balance of the year and beyond.

Because our realized gross margin on monitoring revenue is about twice that of our hardware, its growth has an outsized impact on our bottom line performance. Also, we consider margin revenues to be annual recurring revenues, or ARR, because typically, over 90% of monitoring service plans renew upon their expiration.

Our Q2 performance also benefited from strong demand from large C&I customers, or commercial and industrial customers, for our TrueGuard back-up generator monitors, contributing to a 39% increase in hardware revenue in the period.

Overall, revenue growth of 22% allowed us to cover our public company overhead costs and achieved a consolidated net profit in Q2 versus a net loss in Q2 2022.

On a cash basis, our growth was even better as cash basis revenue grew--rose 33% to $2.1 million in Q2 2023 compared to $1.6 million in Q2 2022 and has increased 9% for the first half of 2023.

We said on our last call that we expected this year to return to a more normal business pattern with Q1 likely our weakest quarter and sales building into Q2 and Q3. Our performance has followed this pattern, so far, and supports our belief that we can achieve our 20% annual cash basis revenue growth goal for the full year 2023.

If we meet our growth goal, we'd also expect to achieve positive cash flow and profitability on a consolidated basis for the full fiscal year 2023.

We have a growing base of commercial and industrial, what we call C&I customers that are facing rising labor and fuel costs, increasing environmental pressures, along with budget constraints and return on investment requirements.

Our solutions provide benefits in each of these areas, making us an ideal partner for a broad array of businesses.

Our customers are, increasingly, attracted to the carbon footprint reduction and benefits of remote monitoring, providing them a prudent path to minimizing the environmental impact.

We believe this trend, combined with our compelling ROI, supports our business development efforts. This C&I effort was very visible in this past quarter when our residential generator dealers were significantly down in sales.

One of the leading generator manufacturers reported that their residential product sales were down 44% in the second quarter, and their C&I product sales were up 24%, compared to their second quarter of 2022.

We are bullish that we will see a rebound in the residential segment and the demand in the C&I segment will continue to increase.

We have a number of newer solutions that we believe have excellent prospects. One is our remote AC mitigation disconnect solution, or RAD, for gas pipelines.

Pipelines generally have devices installed to protect them from corrosion caused by AC voltage created by overhead power lines. These devices need to be periodically disconnected and reconnected for inspection, which is typically a manual process.

Our RAD product connected via cellular satellite network remotely disconnects and reconnects these devices, eliminating the need for human involvement. The RAD solution significantly reduces company expenditures, increases employee safety and delivers meaningful environmental benefits by reducing truck rolls.

We also had a very--we also made very good progress on our Demand Response program for standby generators, which is in partnership with CPower Energy. The program compensates generator owners, as well as OmniMetrix, for enabling grid operators to turn on backup generators to help manage energy loads during peak demand.

OmniMetrix provides the enabling technology and reporting required to allow backup generators to be turned on remotely to provide additional power for Demand Response programs. This added source of power helps grid operators to better meet peak demand and avoid rolling brownouts or blackouts.

Generator demand response programs are available for C&I and residential customers that have deployed new enhanced energy efficient generators. We're working with our base of generator dealers who will market this program to their customers. As this is a brand new capability, there was a fair amount of back-end work and software development that needed to be accomplished between OmniMetrix and CPower.

We have now validated these systems to work together. This development plus our proven connectivity to our monitor generators now allows us to sign up dealers and their customers.

It will take time to educate our dealers and their customers on the value and financial benefits of their participation in Demand Response programs, but we believe this provides a compelling win-win opportunity for generator owners to serve their community, while also generating income to offset the cost of their generator installation in the long run.

Importantly, we expect that the addition of the main response to our monitoring and control solutions will enable us to double our value proposition, revenue and profitability from each demand response customer, as compared to our traditional monitoring end points.

Though it's too early to estimate the pace of Demand Response’s adoption, we do expect it to be an important driver for long-term growth in revenue and profitability. It's important to recognize that DR revenue is very similar to our monitoring revenue and that it is an accretive annual recurring revenue stream.

We continue to see secular trends that will drive demand for our solutions in the future. For example, the United States has an aging power grid and a lack of investment in continuously dispatchable conventional power supplies by fossil fuels and nuclear power in favor of environmentally favorable but intermittent power supplies, such as wind and solar.

At the same time, we anticipated a dramatic increase in electricity demand from population growth and usage of electronics and electric products, most importantly, electric vehicles, which are projected to represent 50% of new vehicle sales by 2030.

As a result, we expect continued stress on energy grids to meet peak power demands as well as challenges in managing through power outages created by increasingly harsh weather patterns. We believe these trends provide a very sound backdrop for the growth of our business in the coming quarters and years.

To further expand our market reach, in May, we hired a West Coast sales manager to pursue opportunities in this market which, historically, has not been a big market for backup power generators given its relatively mild weather.

However, given the impact of extreme events causing power outages such as forest fires, interest in backup generators has been gained traction, and we now believe it represents a very attractive opportunity for growth. The West Coast sales manager has already initiated a number of sales orders and is generating a lot of interest for potential future business.

Acorn closed Q2 2023, with $1.6 million of cash, no debt and cash flow positive business in the quarter in six months. We believe the company is well positioned for organic growth and also to explore other opportunities to further build shareholder value.

We continue to evaluate potential growth and value-creating opportunities. We are very disciplined in this effort in order to ensure that we remain aligned with our current lines of business and focus on creating shareholder value.

Our strategic and value discipline create a high hurdle for us to meet in executing on external growth opportunities. But we believe protecting the value we have created is our first priority in this process.

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

Tracy Clifford
Thanks Jan. In addition to our press release, we also filed our 10-Q this morning with the SEC. Now, I'll provide an overview of our results, before we open the call to your questions.

The numbers that we'll discuss are consolidated on a GAAP basis, except cash basis revenue, which is a non-GAAP measure that we reconcile to GAAP revenue in our press release.

Q3 ’23, revenue rose 22% to $2.0 million, driven by a 39% increase in hardware revenue, primarily for TrueGuard generator monitors, both for C&I and residential customers. We've seen strength in our business across the board and, particularly, from large national customers for remote monitoring and control of backup generators. Through the first six months, revenue increased 10% to $3.7 million, reflecting the strength.

We've noted before that currently, we record the majority of our hardware sales as deferred revenue in accordance with GAAP and 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 sales and monitoring services, however, begins at the time of shipment and collected in accordance with payment terms within 30 to 90 days. The current accounting treatment results in a deferred revenue balance, which reached a record level of $6.4 million in the second quarter, up from $5.6 million a year ago.

Internally, we focus on cash basis revenue because it gives a more quantitative measure of year-over-year sales trends and is the primary indicator of future GAAP revenue to be recognized.

As Jan mentioned, our cash basis revenue increased 33% to $2.1 million in Q2 ’23, from $1.6 million in Q2 ‘22. And cash basis revenue rose 9% to $4.0 million in the first six months of 2023.

Q2 2023 gross profit increased to $1.5 million, reflecting a gross margin of 76% as compared to a gross profit of $1.2 million with a gross margin of 77% in Q2 ‘22.

A slight decline in the gross margin reflects more hardware in the Q2 ‘23 revenue mix. Gross margin on hardware was 55% in both Q2 ‘23 and Q2 ‘22. Gross margin on monitoring was 93% in Q2 ‘23 and 92% in Q2 ‘22.

Operating expenses decreased 4.2% to $1.4 million in Q2 ‘23 from $1.5 million in Q2 ‘22, reflecting a onetime $51,000 software impairment charge in the prior year period and modestly lower research and development expenses in Q2 ‘23.

We do expect SG&A cost to increase in the second half of 2023 due to staff additions and other personnel costs, as well as IT consulting and staff augmentation for new IT projects and initiatives. Investments in IT and R&D activities allow OmniMetrix to remain a technology and product leader in our business. These investments have also allowed us to grow market share, particularly in the C&I segment, where we continue to introduce the new solutions and product enhancements.

Net income attributable to Acorn stockholders improved to $96,000, or $0.00 per share in Q2 ‘23 from a loss of $223,000, or $0.01 per share in Q2 2’2, reflecting strong revenue growth and lower operating expenses.

Likewise, for the six-month period ended June 30, 2023, net income improved to $11,000, or $0.00 per share versus a loss of $346,000, or $0.01 per share in the first six months of ‘22.

Acorn generated $155,000 of cash from operating activities in the six months ended June 30, 2023, attributable to net income plus noncash expenses. We also invested $37,000 in technology in the six months ended June 30, 2023, for hardware purchases, minor software technology upgrades and continued investment in the development of the new user interface for our monitoring customers to view their data, which we refer to as OmniU 2.0 and is planned for launch in the fourth quarter.

In terms of our balance sheet, inventory increased to $803,000 from $789,000 at year-end. We're still maintaining some excess inventory to mitigate any delays in product delivery for large volume customers and to increase our ability to facilitate growth.

We had consolidated cash of $1.6 million on June 30th, and we had $1.7 million as of August 8th with no debt.

We believe our strong balance sheet provides solid support for our growth strategy, including necessary and/or opportunistic investments. Overall, we continue to be very excited about the prospects for remote monitoring and control solutions, including demand response in the second half and over the longer term. We look forward to updating you on our progress on all of these fronts on our next call.

And with that, Operator, please open the call for investor questions.

QUESTION AND ANSWER

Operator
We will now begin the question-and-answer session. To ask a question, you may press “*”, then “1” on your telephone keypad. If you are using a speaker phone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press “*”, then “2”.

At this time, we will pause, momentarily, to assemble our roster.

Our first question comes from Scott Searle with ROTH MKM. Please go ahead.

Scott Searle
Good afternoon--excuse me, good morning. Thanks for taking the questions and nice to see the monitoring revenue recurring. And maybe, Jan, just to start, could you give us some idea of C&I versus residential in the quarter? It sounds like C&I was definitely the driver. But kind of give us an idea about from a net add standpoint, how is that mix skewing and maybe calibrate us towards what the installed base looks like?

And then looking forward on the residential front, what have been the headwinds here? Is this predominantly interest rates? Is it something else? Or are there channel inventory issues that they're doing with, and what's the expected timeline of the recovery on that front?

Jan Loeb
Okay Scott, thank you for your questions. Firstly, in terms of C&I versus residential, as a company today, we are roughly 65% residential and 35% of C&I. In terms of the quarter, I might not give you the number, but I can tell you that C&I was substantial--substantially larger in the quarter than was residential, but residential, just because of our--the size of our base in residential it does throw especially on the monitoring side, it is the predominance of the revenue generation.

In terms of what we're seeing out in the marketplace, yes, interest rates are a very big factor. And almost all generators are financed, $15,000 is not something you just have out of pocket by and large. Again, I'm talking on the residential side.

So, interest rates have been a factor. I think the economy in general has been a factor. People--if you’re a little bit scared, a generator is viewed in terms of the residential generators view it as more of a luxury item than necessity. We think, over time, that changes somewhat because of the grid.

On the C&I side, it's certainly much more so a necessity today than it is a luxury. So, I think the economy also plays a factor.

In terms of the ability for the generator manufacturers to get the product out, I think that there is--in certain areas, there's still a backlog, but our dealers are saying that, by and large, they can get generators today. I'm not saying every dealer, but if you're a top dealer--certainly, a lot of our customers are--I think, by and large, you can get inventory if you need it.

Scott Searle
Got you. Thank you. And if I could just follow-up with one more. Looking forward to the guidance of cash growth of 20%. You've got some new solutions coming out in terms of the RAD closure pipe, as well as DR. It sounds like it's early days, but I'm wondering if you could give us an idea

of how that pipeline is building the visibility on that front and how that really factors into both guidance in the second half of this year and then as we start to think about ‘24? Thanks.
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Jan Loeb
So, I’ve said on previous calls, and I'll reiterate now that I don't think that either of those factors are going to be big factors in--really any factor in 2023. I think they kind of start towards the end of 2023. And they've become bigger factors over time, especially on the DR side, as we said, there's an education process. So, we don't know how fast the adoption is going to be.

I can tell you that at the EGSA Conference, which is the industry generator conference, October 1st and October 2nd, CPower, which is the largest company providing power to the ISOs has a presentation with us at the conference, and they will be with us in the booth.

So, we're certainly trying our best to get the word out. I think that will have a major impact for our dealers.

So, I think it really has no impact in 2023. It builds in 2024. And as we've said, it is an annual renewable revenue stream and so it cumulatively builds, thereafter. But the numbers can be quite large.

And if you look at what Ercot is paying for somebody to sign up for a program on standby generator of $70,000 per megawatt, the numbers can be quite large as the program grows.

In terms of the RAD, we still have our trials out, again, a new product in an industry that takes time and has long lead-times for sales. So, I think that, again, is--has a very nice impact in 2024 and beyond.

Scott Searle
Great. Thank you.

Operator
Our next question comes from Edward Gilmore, private investor. Please go ahead.

Edward Gilmore
Thank you. Hi Jan, good morning and thanks for taking the call and it's nice to see the good results, this morning. I had a question on artificial intelligence. I was just kind of wondering your kind of general perspective on that. With everything going on in AI and all the monitoring on the metrics can do and the data that's able to be collected. But wondered if you see any opportunities on the horizon there that might be beneficial for the product suite?

Jan Loeb
I--right this second, we don't see it. We certainly have our eyes on it. We are pulling data, actual data, from 25,000 pieces of equipment. So, we are a data rich company.

And obviously, the more analytics people want and need the more we can supply, and we're certainly seeing that on our C&I business. The people who had in the past, had what we call dumb monitors, green light-red light-works-it doesn't work, I'm more focused on acquiring data.

So, we think over time, AI certainly could have an impact and a positive impact. But right now, for us, it's too early in the game.

Edward Gilmore
Okay, great. Thank you. And then just another question on the backlog, if I might. It's great to see that high of a backlog there, I think it was 60% or so committed for the rest of the year. And I just wondered how much of the existing inventory is able to go to fill the backlog demand there. Thank you.

Jan Loeb
I mean, in inventories, we have inventory of different products. I can't tell you that every--we have inventory of antennas that might go for the full year, but we have PC boards that we're continuing to order. So, I can tell you that we continuously order, and we have a significant amount of inventory coming in, and we have a significant amount of inventory going out.

Tracy Clifford
If I might add to that response, I think actually what he's seeking is on the backlog. There really is no need for inventory to fulfill that. So, those aren't a backlog of orders. That is the deferred revenue for units that have already been installed and it's just a function of GAAP.

So, none of the existing inventory is required to satisfy that deferred revenue because it's not an actual backlog of orders to be filled. Does that answer your question?

Edward Gilmore
Yes. Thank you, Tracy. Appreciate that. Thank you very much. Thank you, too, Jan. That's all the questions I had.

Jan Loeb
Thank you.

Operator
Again, if you'd like to ask a question, please press "*", then "1" at this time.

Bill Jones
Operator, this is Bill Jones, Investor Relations. We have a question that was e-mailed from a private investor, if I may.

Operator
Please go ahead.

Bill Jones
Okay. The question is from Tom, private investor. And the gist is--of the question is, he's asking--it says in the recent proxy materials, he noticed that you're requesting authority to reverse stock split--to do a reverse stock split. You've had that authority and to date, have chosen not to do so. Could you explain why you would or would not, given that the reverse split could allow more people potentially to buy the stock if it's not a penny stock?

Jan Loeb
Okay. So, definitely correct. We've had permission to reverse stock and a number of investors have said to us that we should do that in order to make it easier to purchase the stock because a number of brokerage firms don't allow customers to buy stock.

So, I, in the past, have been hesitant to do that because, historically, in the 40-plus years that I've been on Wall Street, the reverse stock split typically lose value after the reverse split. So, I've been hesitant to do that.

There's usually only one reason to go ahead with it. And that is--and I've said this in the past that if we have some good news and kind of good news to come, meaning a string of good events, that would give me the confidence that reverse the stock split that did not lose value, but will rather gain value for our company.

And so, if we do a reverse stock split, and we announce that we're going to do a reverse stock split, I think one can rest assured that we feel very confident about the future, and we have some good news coming. But until that time, I've so far been hesitant to do it. But we'll see what happens into the future. I hope that answers Tom's question.

Bill Jones
Thank you, Jan.

CONCLUSION

Operator
This concludes the question-and-answer session. I will now turn the call back over to Mr. Jan Loeb for his closing remarks.

Jan Loeb
Thank you, everyone, for your interest in Acorn Energy. We look forward to updating investors on our Q3 conference call. And as always, we will update you in the interim via press releases with any material developments.

We appreciate your support and I'm happy to speak with investors or prospective investors about our company. You can set up a call with myself and Tracy or ask a question to our IR team, who's contact information is in today's press release. Until then, we thank you all for joining our call, today. All the best.

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