Zacks Small-Cap Research

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Acorn Energy, Inc. (ACFN-NASDAQ)

ACFN: Zacks Co. Report – OUTPERFORM

Raising target to $7.75 based on revenue growth from recently announced orders, along with expected production orders at USSI.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	08/29/2010
Current Price (01/19/12)	$6.68
Six- Month Target Price	**$7.75**

OUTLOOK

Acorn Energy sold its 65%-owned CoaLogix subsidiary for a fully-priced 4.9 times 12-month trailing sales. The after-tax proceeds were approximately $58 million or $3.32 per share. Subsequently, the Board approved both a regular and a special dividend. With over $50 million available for investment and revenues growing from recently announced orders, we are now utilizing a P/S valuation methodology based on annualized sales. We maintain our Outperform rating and raise our price target to $7.75.

SUMMARY DATA

52-Week High	**$6.94**
52-Week Low	**$3.46**
One-Year Return (%)	**65.90**
Beta	**0.65**
Average Daily Volume (shrs.)	**39,823**
Shares Outstanding (million)	**17.5**
Market Capitalization ($ mil.)	**$117**
Short Interest Ratio (days)	**0.99**
Institutional Ownership (%)	**34**
Insider Ownership (%)	**7**
Annual Cash Dividend	**$0.14**
Dividend Yield (%)	**2.10**
5-Yr. Historical Growth Rates	
Sales (%)	**83.5**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**4.0**
P/E using 2012 Estimate	**N/M**
P/E using 2013 Estimate	**N/M**
Zacks Rank	**2**

Risk Level	**Above Average**
Type of Stock	**Small - Value**
Industry	**Elect. Prods. – Misc.**
Zacks Rank in Industry	**8 of 24**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	7.1 A	8.2 A	9.5 A	10.9 E	35.7 E
2011	6.8 A	10.7 A	5.1 A	6.3 E	29.0 E
2012	5.7 E	6.1 E	6.8 E	7.7 E	26.3 E
2013					29.1 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2010	-$0.08 A	-$0.01 A	-$0.14 A	-$0.26 A	-$0.50 A
2011	-$0.13 A	-$0.12 A	$2.33 A	-$0.03 E	$2.11 E
2012	-$0.06 E	-$0.05 E	-$0.01 E	$0.01 E	-$0.11 E
2013					-$0.01 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

Quarterly numbers may not equal annual total due to rounding.

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KEY POINTS

- Based on strong order flow at DSIT and USSI, a war chest of over $50 million from the sale of CoaLogix and increased institutional ownership, we are raising our target of Acorn energy's stock to $7.75.
- On August 31st, **Acorn Energy sold its majority-owned CoaLogix subsidiary** for $101 million or 4.9 times 12-month trailing sales. Acorn Energy owned approximately 65% of CoaLogix on a fully diluted basis. After-tax proceeds were approximately $58 million or $3.32 per share. Not only did the capital inflow provide the Board the opportunity to **initiate a regular and announce a special dividend**, but also the added capital allows management to consider opportunistic acquisitions of other early-stage energy infrastructure operations to further enhance shareholder value.
- Acorn Energy is a holding company with a portfolio of three operating companies that are focused on addressing the challenges of the energy sector, particularly the opportunities in repairing, monitoring, updating, expanding, and protecting the existing global energy infrastructure.
- CEO John Moore has a successful track record of investing in small emerging companies and enhancing their value. Shareholders of Acorn Energy have the opportunity to participate in his latest venture into Cleantech.
- **DSIT** is expected to continue to grow both top-line revenue and net income driven by new orders. A major **significant order totaling $12.3 million** from an undisclosed Asian customer was announced in December.
- **GridSense** provides a range of smart monitoring sensors and systems that provide real-time information in electric power transmission and utility distribution networks. A major TransformerIQ monitoring project being implemented by a leading southeastern electric utility should drive other utilities to follow suit when positive results of the installations are announced.
- **US Sensor Systems** (USSI) designs, manufactures, and sells optical fiber sensing systems to the energy and defense markets. USSI has significant potential in the adoption of 4D seismic technology by oil and gas companies to monitor fracturing in extracting shale gas and to map out underground reservoirs for advanced extraction techniques. **During 2011, USSI has received five significant oilfield application orders that should lead to considerable follow-on orders in 2012**.

OVERVIEW

Based in Montchanin, Delaware, Acorn Energy (ACFN) is a holding company of three operating companies, which share the common theme of applying technology to improve the productivity and security of existing infrastructure within various energy industries. Currently, all three operating companies are consolidated with **DSIT Solutions Ltd**., being 84% owned by Acorn Energy and **GridSense Pty Ltd**. being wholly-owned. Acorn Energy has increased its ownership of **US Sensor Systems** (USSI) with its options to 81%. Acorn owns a 10% equity interest in Coreworx, along with a 10% warrant interest, and a $4 million secured note. In 2010, CoaLogix (now sold) accounted for 60% of revenues, DSIT Solutions Ltd. 32%, GridSense 7% and US Sensor 1%.

Acorn Energy is focused on addressing the challenges of the energy sector, from improving the efficiency and environmental impact of energy production to dealing with security risks related to the ownership of large energy assets. There are substantial business opportunities in repairing, monitoring, updating, expanding and protecting the existing global energy infrastructure. Acorn's strategy is to take controlling positions (at significant discount to previously invested capital) in viable companies that are and will be benefiting from these opportunities. In 2010 (which included CoaLogix), 63% of consolidated revenues were generated in the U.S. & Canada, 16% in Israel, 16% in Asia, 4% in Oceania and 1% in Other.

The **drivers in 2012** are expected to be 1) the continued and **growing profitability of DSIT** due to the major $12.3 million order announced in December, 2) the **receipt of significant production contracts**

by US Sensor Systems from the five pilot programs under proof-of concept orders from oilfield service and equipment companies last year and 3) **GridSense benefiting later in the year from the successful TransformerIQ monitoring project** by a leading southeastern electric utility as other utilities are able to observe the cost effectiveness of employing smart monitoring systems for electricity transmission and distribution networks. In addition, with over $50 million available for investment, management has the capacity to expand its portfolio of businesses with either bolt-on acquisitions or potentially another operating company.

Under John Moore's tenure as Chief Executive Officer, **Acorn Energy has monetized two subsidiaries in the last four years**. In April 2007, **Comverge** (COMV: NASDAQ) went public at eight times 12-month trailing revenues, and in December 2007, Comverge completed a secondary offering lead by Goldman Sachs (GS: NYSE) at 16 times revenues. Acorn Energy sold 889,005 shares of COMV stock for $25.8 million in the secondary offering, 1,261,165 shares for $15.4 million in 2008, and the remaining 502,500 shares for $4.0 million in 2009. In August 2011, Acorn Energy sold of **CoaLogix** to Energy Capital Partners for $101 million (or 4.9 times 12-month trailing sales). Acorn Energy owned 65% of CoaLogix and received gross proceeds of $61.9 million on an investment of approximately $18.2 million since its acquisition in 2007. After-tax proceeds were approximately $58 million or $3.32 per share.

Acorn Energy is a member of the Russell Microcap Index.

RECENT NEWS

On January 4, 2012, **Verition Fund Management LLC filed a 13G** declaring its ownership of 888,541 shares of Acorn Energy or 5.07% of the outstanding shares of the company based upon 17,516,943 shares outstanding as of November 2, 2011.

On December 13, 2011, Acorn Energy announced that its GridSense subsidiary developed a maintenance-free and **battery-less monitoring system**, allowing for the monitoring of dead-front transformers and underground feeders where AC power supply is not available. The battery-less system draws power from insulated cables and is currently deployed in California by a major utility.

On December 8, 2011, Acorn Energy announced that its 84%-owned **DSIT subsidiary received a very significant order from an undisclosed Asian customer**. It is believed that the **$12.3 million contract** is the largest order for any underwater security system designed to protect energy infrastructure. It definitely is the largest order received by any of Acorn Energy's subsidiaries. Composed of a large number of AquaShield Diver Detection Sonar systems and PointShield Portable Diver Detection Sonar systems, deliveries are expected to begin in the fourth quarter of 2011 and span into 2012. With revenues at DSIT having been under pressure recently, primarily due to the delay of a follow-on order of a large expansion project, both the top and bottom lines of DSIT will benefit from this order, which potentially will enable DSIT's revenues to double in 2012.

On November 9, 2011, Acorn Energy reported **third quarter results** for the period ending September 30, 2011. Revenues decreased 46.8% to $5.05 million from $9.50 million, primarily due to the sale of CoaLogix. **Eliminating the effect of CoaLogix, revenues increased 25.6% as a result of the 279% increase in sales at GridSense.** Total gross profit declined 33.5% to $1.81 million from $2.72 million in the comparable-period last year. The gross profit margin increased 718 basis points (bps) to 35.8% from 28.6%, primarily due to the removal of the low gross margin CoaLogix operations. **Acorn reported a quarterly gain of $40.8 million or $2.33 per diluted share, which was above our estimate of $2.05.**

Revenues at DSIT declined 25.0% to $2.39 million in the third quarter, primarily due to the delay of progress on an already ordered DDS system as a result of altering configurations of the system. The gross margin declined 2,030 basis points (bps) to 22.8% from 43.1% in the comparable-period last year

due to the delay on an AquaShield project. For the year, revenue growth and the level of profitability are dependent upon the receipt of an anticipated major follow-up order.

Revenues at GridSense increased 279% year-over-year to $2.54 million from $671 thousand, which was well above expectations. Revenue growth was driven by a major TransformerIQ monitoring project by a leading southeastern electric utility to deploy at least 750 TransformerIQ's to monitor over 2,000 transformers in one metropolitan county. Sequentially, the gross margin was relatively stable, increasing 19 basis points (bps) to 48.6% from 48.4% in the second quarter, holding on to the economies of scale and lower production costs from shifting production from Australia to a lower-cost facility in California.

USSI reported a 28.9 decline in revenues to $114 thousand, down from $160 thousand in the comparable-period last year. Through the first nine months of 2011, USSI has received five significant orders that are currently in pilot programs under proof-of concept contracts from oilfield service and equipment companies. The value of three of the proof-of concept contracts is over $1.6 million, which should be booked over the next 15 months; however, **these contracts could generate $36 million in annual revenues if they transition from development to production.** To prepare for this expected growth, USSI leased a 21,000 square foot of office-production-warehouse facility in Chatsworth, California (San Fernando Valley), more than quadrupling USSI's workspace. Despite the additional expense, **USSI achieved a gross profit during the quarter**.

On October 17, 2011, Acorn Energy announced at its annual meeting that the Board of Directors approved the **initiation of a regular quarterly dividend** of $0.035 per share and a 2011 year-end special dividend of $0.05 per share. The quarterly dividend will be paid on November 28, 2011 to shareholders of record on November 16th. The **special year-end dividend** was paid on January 9, 2012 to shareholders of record on December 28th.

On August 31, 2011, **Acorn Energy closed the sale of CoaLogix** for $101 million to Energy Capital Partners. Acorn Energy owned approximately 65% of CoaLogix on a fully diluted basis and received gross proceeds of $61.9 million or $3.53 per share of Acorn Energy. After-tax proceeds were approximately $58 million or $3.32 per share. UBS Investment Bank acted as exclusive financial advisor to CoaLogix.

INSTITUTIONAL OWNERSHIP

Institutional investors owned approximately 28.9% of the outstanding shares of the company at the end of the latest reporting period (September 30, 2011). Total holdings by institutions increased 1.2 million shares (or 6.9% of the shares outstanding) during the last reported quarter. Columbia Wanger Asset Management, LLC was the largest holder (13.3%), including the purchase of 2,324,301 shares during the latest quarter. Other major institutional holders include: Dimension Fund Advisors (2.8%), Austin W. Marxe and David M. Greenhouse (2.5%), Cutter & CO Brokerage (1.4%) and Ameriprise Financial (1.3%). All of the major holders increased their holdings during the quarter except Austin W. Marxe and David M. Greenhouse (2.5%) and Cutter & CO Brokerage, which decreased their holdings. Subsequent to the required quarterly institutional investors reporting period on January 4, 2012, Verition Fund Management LLC filed a 13G declaring its ownership of 888,541 shares (up from 12,050 shares at the end of the third quarter) or 5.07% of the outstanding shares of the company based upon 17,516,943 shares outstanding as of November 2, 2011. Therefore, it appears that **institutional ownership is currently approximately 33.9%.**

VALUATION

The appropriate valuation methodology for Acorn Energy is based on price-to-sales (P/S) due the character of Acorn's enterprise, namely a small-capitalization company with negative profitability, but with a sales profile that should grow and expand over time as management makes investments in the underlying businesses. Ultimately, the growing revenue stream should manifest itself into positive earnings. Based on historical norms for similar companies and the company's historical P/S range, **a price-to-sales valuation range between 1.1 and 3.2 is expected.**

With the recent sale of CoaLogix, the company has excess cash of $3.32 per share. In addition, due to management's successful execution on its strategy, all three subsidiaries are benefiting from important orders. DSIT received a significant $12.3 million order in December that should generate increased revenues in 2012. US Seismic Systems received five significant orders for pilot programs from oilfield service and equipment companies in 2011 that are expected to generate major production orders in 2012. Lastly, GridSense should benefit in the second half of 2012 from the major TransformerIQ monitoring project being installed by a leading southeastern electric utility. When positive results of the installations are announced, other utilities should follow suit by implementing GridSense's Smart Grid distribution network monitoring solutions. **Due to the expected accelerating growth of the sales base, our price target is now being based on a P/S valuation on annualized current quarter sales** of the remaining three operating companies plus the excess cash on the company's balance sheet. Previously, we utilized a P/S ratio on trailing 12-month sales. **Based on the high-end 3.2 price-to-sales ratio valuation on annualized quarter sales**, our price target for the fourth quarter of 2011 (utilizing reported results for the third quarter) would have been $6.95. However, **our price target for the first quarter of 2012** (based on our expected results for the fourth quarter) **is $7.75**.

Significant fundamental events can considerably increase the company's valuation parameter in a step-fashion. One such event would be the company's achievement of positive profitability, in which case the stock could experience multiple expansion in short order. Management has the ability to dramatically lower SG&A and achieve profitability sooner than expected, since current expenses are above-trend due to heavy investments aimed at driving revenue growth.

Another step-up event would be the re-valuation of one of the company's operating companies, possibly through an initial public offering (IPO) or an industry demand-enhancing catalyst. Investors should be cognizant of precedents with somewhat similar characteristics. For example, the anticipation for increased usage of smart meters and the expected government stimulus for electricity grid modernization drove Itron's stock (ITRI: NYSE), a mid-sized manufacturer of smart meters, to a 5.7 price-to-sales valuation in mid-2007. CEO John Moore sold Comverge at 16 times revenues in 2007 and CoaLogix at 4.9 times sales in 2011.

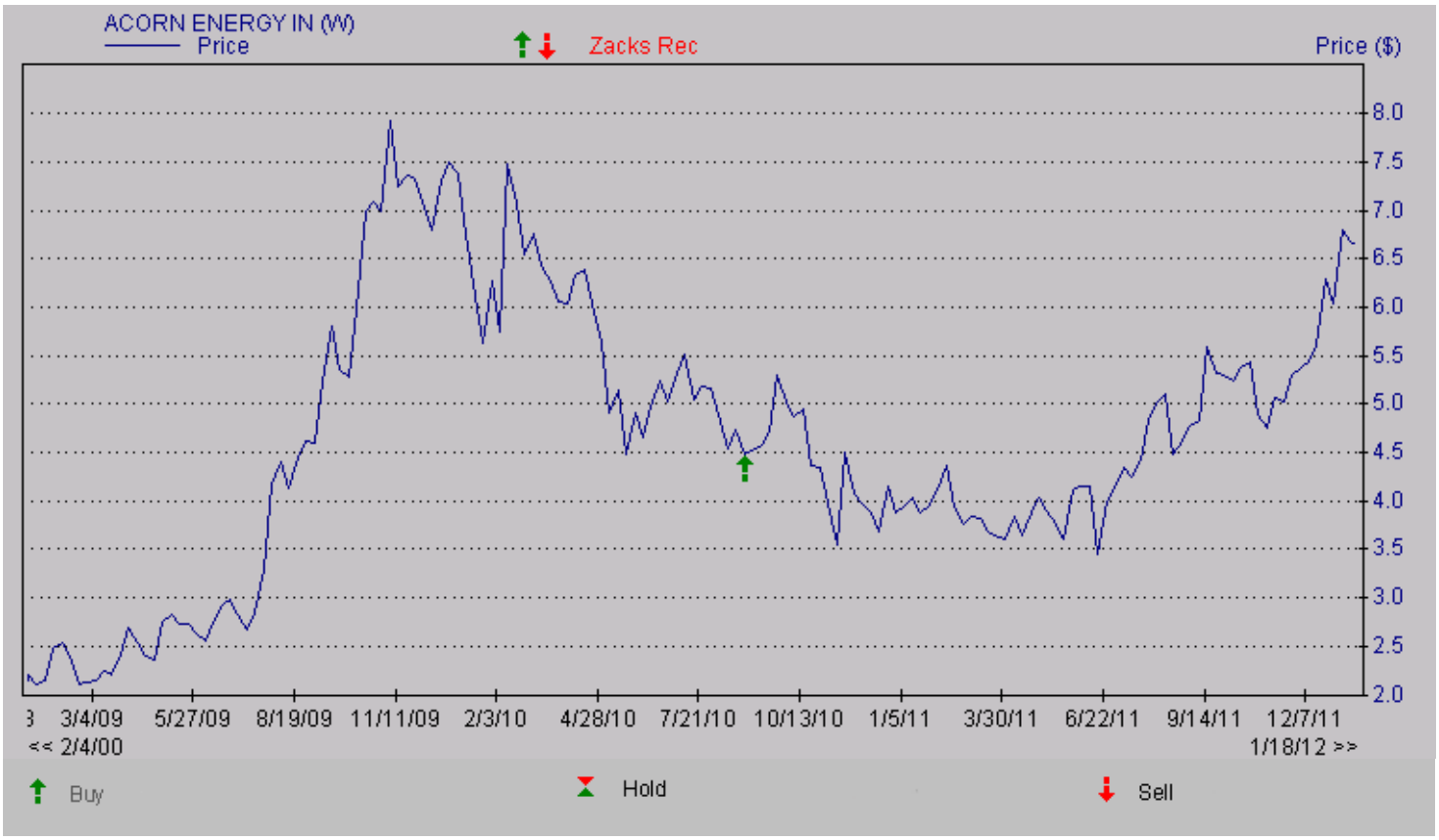
When the company achieves a permanent upward shift in the level of profitability, the appropriate valuation methodology should shift to the price-to-earnings (P/E) ratio unless the foundation of the business' demand is highly sensitive to the economic cycle. When a price-to-earnings ratio is applicable, other factors, such as the operating margin and return-on-equity, will take on increased importance in determining the expected P/E valuation range.

PROJECTED INCOME STATEMENT

Acorn Energy Earnings Model

YEARS ENDING 12/31		2009	Q1	Q2	Q3	Q4	2010	Q1	Q2	Q3	Q4 E	2011 E	Q1 E	Q2 E	Q3 E	Q4 E	2012 E	2013 E
INCOME STATEMENT (000 except EPS)																		
CoaLogix	revenues	**18,099**	4,478	4,855	5,479	6,638	**21,450**	3,747	6,612	0	0	**10,359**	0	0	0	0	**0**	**0**
DSIT	revenues	**9,219**	2,507	2,823	3,189	2,843	**11,361**	2,348	2,509	2,393	3,600	**10,850**	3,800	4,000	4,200	4,400	**16,400**	**18,368**
GridSense	revenues			517	671	1,194	**2,382**	641	1,499	2,544	2,550	**7,234**	1,700	1,800	2,000	2,400	**7,900**	**8,374**
US Sensor	revenues		99	32	160	212	**504**	106	99	114	200	**519**	250	300	600	900	**2,050**	**2,358**
TOTAL REVENUES		**27,318**	**7,084**	**8,227**	**9,499**	**10,887**	**35,697**	**6,842**	**10,719**	**5,051**	**6,350**	**28,962**	**5,750**	**6,100**	**6,800**	**7,700**	**26,350**	**29,100**
CoaLogix	cost of goods sold	**11,803**	2,546	3,000	4,563	4,224	**14,333**	2,665	4,976	0	0	**7,641**	0	0	0	0	**0**	0
DSIT	cost of goods sold	**5,264**	1,342	1,558	1,815	1,851	**6,646**	1,467	1,904	1,848	2,736	**7,955**	2,774	2,720	2,730	2,772	**10,996**	11,204
GridSense	cost of goods sold	**0**		191	321	698	**1,210**	371	773	1,307	1,301	**3,752**	918	1,008	1,080	1,224	**4,230**	4,354
US Sensor	cost of goods sold	**0**	82		84	260	**344**	83	83	89	148	**403**	180	210	408	594	**1,392**	1,485
TOTAL COST OF GOODS SOLD		**17,067**	3,970	4,749	6,783	7,032	**22,533**	4,586	7,736	3,244	4,185	**19,751**	3,872	3,938	4,218	4,590	**16,618**	**17,044**
Gross Profit		**10,252**	**3,114**	**3,478**	**2,716**	**3,855**	**13,164**	**2,256**	**2,983**	**1,807**	**2,166**	**9,212**	**1,878**	**2,162**	**2,582**	**3,110**	**9,732**	**12,055**
TOTAL SG&A		**12,028**	4,147	4,662	4,629	4,247	**17,685**	4,558	4,762	3,142	3,000	**15,462**	3,200	3,400	3,000	3,000	**12,600**	**13,608**
	R&D expense	**(543)**	(48)	(189)	(282)	(612)	**(1,131)**	(588)	541	(713)	(254)	**(1,014)**	(230)	(244)	(272)	(308)	**(1,054)**	**(1,128)**
	Dividends from EnerTech	**0**	135	0	0	0	**135**	0	0	0	0	**0**	0	0	0	0	**0**	**0**
	Impairments	**(2,692)**	0	0	0	(1,166)	**(1,166)**	0	0	0	0	**0**	0	0	0	0	**0**	**0**
OPERATING INCOME		**(5,011)**	(946)	(1,373)	(2,195)	(2,171)	**(6,684)**	(2,890)	(2,320)	(2,048)	(1,089)	**(7,265)**	(1,552)	(1,482)	(690)	(198)	**(3,922)**	**(2,680)**
	Interest expense	**(86)**	0	(197)	48	(90)	**(239)**	(122)	(109)	262	300	**331**	350	325	300	275	**1,250**	**1,338**
	Gain on Sale CoaLogix (net of taxes)	**0**					**0**			30,683		**30,683**					**0**	**0**
	Gain on Sale Comverge	**1,403**					**0**					**0**					**0**	**0**
	Gain on investment GridSense	**0**	0	1,327	0	0	**1,327**					**0**					**0**	**0**
	Gain on Sale HangXing	**0**					**0**	492				**492**					**0**	**0**
	Loss on sale of EnerTech	**0**	0	0	0	(1,821)	**(1,821)**					**0**					**0**	**0**
Pretax income		**(3,694)**	(946)	(243)	(2,147)	(4,083)	**(7,418)**	(2,520)	(2,429)	28,897	(789)	**24,242**	(1,202)	(1,157)	(390)	77	**(2,672)**	**(1,343)**
	Taxes	**744**	(75)	(123)	(372)	(101)	**(671)**	(65)	26	12,111	0	**12,072**	(50)	(75)	(100)	(125)	**(350)**	**0**
Net Income after taxes		**(2,950)**	(1,021)	(366)	(2,519)	(4,184)	**(8,089)**	(2,585)	(2,403)	41,008	(789)	**36,314**	(1,252)	(1,232)	(490)	(48)	**(3,022)**	**(1,343)**
	Equity income (loss) Paketeria	**263**	0	0	0	0	**0**					**0**					**0**	
	Equity income (loss) GridSense	**(129)**	0	0	0	0	**0**			(393)		**(393)**					**0**	
	Minority interest	**420**	50	265	373	(26)	**662**	368	324	181	217	**1,090**	188	217	259	312	**975**	1,208
NET INCOME before NRI		**(2,396)**	(971)	(101)	(2,146)	(4,210)	**(7,428)**	(2,217)	(2,079)	40,796	(572)	**37,010**	(1,064)	(1,015)	(231)	264	**(2,047)**	**(135)**
	Weighted Avg. Shares Out. Diluted	**11,445**	12,498	15,161	15,721	16,254	**14,910**	17,449	17,489	17,508	17,858	**17,576**	18,215	18,580	18,951	19,330	**18,500**	**19,473**
Zacks Diluted EPS before NRI		**(0.21)**	**(0.08)**	**(0.01)**	**(0.14)**	**(0.26)**	**(0.50)**	**(0.13)**	**(0.12)**	**2.33**	**(0.03)**	**2.11**	**(0.06)**	**(0.05)**	**(0.01)**	**0.01**	**(0.11)**	**(0.01)**

HISTORICAL ZACKS RECOMMENDATIONS



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