Zacks Equity Research

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Acorn Energy, Inc. (ACFN-NASDAQ)

ACFN: Zacks Co. Report – OUTPERFORM

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	08/29/2010
Current Price (05/11/11)	$3.74
Six- Month Target Price	**$5.10**

OUTLOOK

Acorn Energy reported financial results for the first quarter of 2011. Revenues declined 3.4% primarily due to sales slowdowns at CoaLogix and DSIT. However, management correctly predicted the slowdown of sales at CoaLogix and now expects a substantial increase in sales based upon a record level of proposals. In addition, CoaLogix is entering the Chinese SCR market by creating two subsidiaries. Management also anticipates an important follow-up order at DSIT that will maintain DSIT's profitability in 2011. We maintain our Outperform rating and adjust our price target to $5.10.

SUMMARY DATA

52-Week High	**$5.51**
52-Week Low	**$3.55**
One-Year Return (%)	**-28.63**
Beta	**0.86**
Average Daily Volume (shrs.)	**33,496**
Shares Outstanding (million)	**17**
Market Capitalization ($ mil.)	**$65**
Short Interest Ratio (days)	**1.50**
Institutional Ownership (%)	**22**
Insider Ownership (%)	**14**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**69.1**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/M**
P/E using 2011 Estimate	**N/M**
P/E using 2012 Estimate	**N/M**
Zacks Rank	**4**

Risk Level	**Above Average**
Type of Stock	**Small - Value**
Industry	**Elect. Prods. – Misc.**
Zacks Rank in Industry	**24 of 27**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	7.5 A	6.7 A	5.1 A	8.1 A	27.3 A
2010	7.1 A	8.2 A	9.5 A	10.9 E	35.7 E
2011	6.8 A	8.0 E	9.5 E	11.2 E	35.5 E
2012					40.4 E

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

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2009	-$0.02 A	$0.01 A	-$0.06 A	-$0.14 A	-$0.21 A
2010	-$0.08 A	-$0.01 A	-$0.14 A	-$0.26 A	-$0.50 A
2011	-$0.13 A	-$0.13 E	-$0.12 E	-$0.12 E	-$0.50 E
2012					-$0.48 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

- Acorn Energy reported first quarter results for 2011. Revenues declined 3.4%, primarily due to utilities postponing catalyst regeneration work provided by CoaLogix and the delay in an expected follow-up order at DSIT. However, management correctly predicted the slowdown of sales at CoaLogix and now anticipates revenues to substantially increase for the remainder of 2011 based upon record levels of proposals (both in dollar value and absolute quantity) for CoaLogix regeneration projects. Management also anticipates a follow-up order from an existing DSIT customer in the first half of 2011, which would result in DSIT remaining profitable 2011. In addition, CoaLogix is entering the Chinese market (the largest user of coal-derived electricity) by creating two wholly-owned foreign enterprises. CoaLogix International Co. Ltd (Hong Kong) will own 100% of CoaLogix Environmental Technology Co., Ltd. (Shanghai).
- Acorn Energy is a holding company with a portfolio of four 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.
- **CoaLogix** is a major participant in SCR (Selective Catalytic Reduction) catalyst replacement market for coal-fired power plants. CoaLogix will benefit from the increased capacity with the second plant at its Steele Creek (Charlotte, NC) facility having been opened late last year.
- **DSIT** is expected to continue to grow both top-line revenue and net income driven by new orders. DSIT is Acorn's only profitable company.
- **GridSense** provides a range of smart monitoring sensors and systems that provide real-time information in electric power transmission and utility distribution networks.
- **US Sensor Systems** (USSI) designs, manufactures, and sells optical fiber sensing systems to the energy and defense markets. USSI has significant potential in both the fiber optic perimeter security market and the adoption of 4D seismic technology by oil and gas companies to map out underground reservoirs for advanced extraction techniques. Acorn Energy began to fully consolidate USSI in February 2010.
- Consult the initiation report dated September 7, 2010 for full background information.

OVERVIEW

Based in Montchanin, Delaware, Acorn Energy (ACFN) is a holding company of four 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 four operating companies are consolidated with **CoaLogix, Inc.** being 72% owned by Acorn Energy and **DSIT Solutions Ltd**., being 84% owned. **GridSense Pty Ltd**. is 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 accounted for 60% of revenues, DSIT Solutions Ltd. 32%, GridSense 7% and US Sensor 1%.

Acorn 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, 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 major drivers in 2011 are expected to be the additional capacity being brought on line at CoaLogix' second plant and the investment in seismic monitoring products at USSI, along with the broadened product line and improved sales force at GridSense. Proceeds from the December 2010 secondary offering funded these initiatives.

RECENT NEWS

On May 11, 2011, Acorn Energy reported first quarter results for the period ending March 31, 2011. Revenues declined 3.4% to $6.84 million from $7.08 million, primarily due to reduced demand for electricity, which caused utilities to postpone catalyst regeneration work provided by CoaLogix and the delay in an expected follow-up order at DSIT. Revenue growth was below expectations at all four subsidiaries: CoaLogix, DSIT, GridSense and US Sensor. Total gross profit declined 27.6% to $2.26 million from $3.11 million in the comparable-period last year. The gross profit margin decreased 1,100 basis points (bps) to 33.0% from 44.0% in the comparable year-ago quarter, primarily due to the decline in revenues. Acorn reported a quarterly loss from continuing operations of $2.22 million or $0.13 per diluted share.

Management correctly predicted the slowdown of sales at **CoaLogix** and now anticipates revenues to substantially increase for the remainder of 2011 based upon record levels of proposals (both in dollar value and absolute quantity) for CoaLogix regeneration projects. The inventory of SCR modules increased in the last two quarters by $3.1 million to $4.4. During the quarter, CoaLogix received new orders totaling $3.7 million and at the end of March 2011 had a backlog of $7.6 million. CoaLogix is entering the Chinese market (the largest user of coal-derived electricity) by creating two wholly-owned foreign enterprises. CoaLogix International Co. Ltd (Hong Kong) will own 100% of CoaLogix Environmental Technology Co., Ltd. (Shanghai).

Despite the 6.3% decline in revenues in the first quarter at **DSIT**, management expects DSIT to report revenue growth in 2011 and to remain profitable. However, the growth and the level of profitability are partly dependent upon an anticipated follow-up order from an existing customer in the first half of 2011.

Due to continued weakness in utility spending, revenues at **GridSense** have not increased as expected. Some utility spending is dependent on federal grants, several of which have been awarded; management expects to benefit from these grants soon. In 2011, GridSense is still expected to gain from the investment in its sales force. In the meantime, management is reducing costs by moving production from Sydney, Australia to Sacramento, California.

USSI is expected to close some major contracts with over a dozen pilot programs at utilities. The company has leased office, production and warehouse space in Chatsworth, California in anticipation of the expected growth at USSI in the second half of 2011.

On December 20, 2010, Acorn Energy announced a registered direct common stock offering of 1,150,000 common shares at $3.50 per share to the public and a warrant exercisable into 80,500 common shares at $3.68 to HFP Capital Markets. The net proceeds were $3.7 million. HFP Capital Markets LLC acted as placement agent for the offering.

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. Our $5.10 price target is based on a 2.5 price-to-sales ratio valuation. At $3.74, the current P/S ratio of Acorn's stock is 1.84.

A critical step in the methodology of determining the appropriate price-to-sales ratio is the debt level of the company. Debt should be added to the "price." In other words, the price-to-sales ratio is calculated as equity plus debt divided by sales.

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. And CEO John Moore sold Comverge at 16 times revenues, also in 2007.

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 & BALANCE SHEET

Acorn Energy Earnings Model

	YEARS ENDING 12/31	Q1	Q2	Q3	Q4	2009	Q1	Q2	Q3	Q4	2010	Q1	Q2 E	Q3 E	Q4 E	2011 E	2012 E
INCOME STATEMENT (000 except EPS)																	
CoaLogix	revenues	5,390	4,547	2,824	5,338	**18,099**	4,478	4,855	5,479	6,638	**21,450**	3,747	4,571	5,577	6,804	**20,699**	**23,804**
DSIT	revenues	2,061	2,158	2,254	2,746	**9,219**	2,507	2,823	3,189	2,843	**11,361**	2,348	2,630	2,945	3,299	**11,222**	**12,568**
GridSense	revenues							517	671	1,194	**2,382**	641	718	804	901	**3,064**	**3,431**
US Sensor	revenues						99	32	160	212	**504**	106	122	140	161	**529**	**609**
TOTAL REVENUES		7,451	6,705	5,078	8,084	**27,318**	7,084	8,227	9,499	10,887	**35,697**	6,842	8,041	9,467	11,165	**35,514**	**40,413**
CoaLogix	cost of goods sold	3,534	2,931	2,126	3,211	**11,803**	2,546	3,000	4,563	4,224	**14,333**	2,665	3,055	3,727	4,546	**13,993**	**15,711**
DSIT	cost of goods sold	1,293	1,214	1,293	1,464	**5,264**	1,342	1,558	1,815	1,851	**6,646**	1,467	1,578	1,767	1,979	**6,791**	**7,541**
GridSense	cost of goods sold					**0**		191	321	698	**1,210**	371	395	434	477	**1,677**	**1,819**
US Sensor	cost of goods sold					**0**	82		84	260	**344**	83	95	107	119	**404**	**457**
TOTAL COST OF GOODS SOLD		4,827	4,145	3,420	4,675	**17,067**	3,970	4,749	6,783	7,032	**22,533**	4,586	5,122	6,035	7,122	**22,865**	**25,527**
Gross Profit		2,624	2,560	1,658	3,409	**10,252**	3,114	3,478	2,716	3,855	**13,164**	2,256	2,919	3,432	4,042	**12,649**	**14,886**
TOTAL SG&A		2,784	2,946	2,960	3,338	**12,028**	4,147	4,662	4,629	4,247	**17,685**	4,558	4,923	5,316	5,742	**20,539**	**22,182**
	R&D expense	(85)	(165)	(136)	(157)	**(543)**	(48)	(189)	(282)	(612)	**(1,131)**	(588)	(322)	(331)	(447)	**(1,688)**	**(1,806)**
	Dividends from EnerTech					**0**	135	0	0	0	**135**					**0**	**0**
	Impairments	(70)	(10)	0	(2,612)	**(2,692)**	0	0	0	(1,166)	**(1,166)**					**0**	**0**
OPERATING INCOME		(315)	(561)	(1,438)	(2,698)	**(5,011)**	(946)	(1,373)	(2,195)	(2,171)	**(6,684)**	(2,890)	(2,326)	(2,216)	(2,146)	**(9,578)**	**(9,102)**
	Interest expense	(102)	(92)	118	(10)	**(86)**	0	(197)	48	(90)	**(239)**	(122)	(122)	(122)	(122)	**(488)**	**(700)**
	Gain on Sale Comverge	417	810	176	0	**1,403**					**0**					**0**	**0**
	Gain on investment GridSense					**0**	0	1,327	0	0	**1,327**					**0**	**0**
	Gain on Sale HangXing					**0**					**0**	492				**492**	**0**
	Loss on sale of EnerTech					**0**	0	0	0	(1,821)	**(1,821)**					**0**	**0**
Pretax income		0	157	(1,144)	(2,708)	**(3,694)**	(946)	(243)	(2,147)	(4,083)	**(7,418)**	(2,520)	(2,448)	(2,338)	(2,268)	**(9,574)**	**(9,802)**
	Taxes	0	0	72	672	**744**	(75)	(123)	(372)	(101)	**(671)**	(65)	(112)	(113)	(113)	**(403)**	**(500)**
Net Income after taxes		0	157	(1,072)	(2,036)	**(2,950)**	(1,021)	(366)	(2,519)	(4,184)	**(8,089)**	(2,585)	(2,560)	(2,451)	(2,381)	**(9,977)**	**(10,302)**
	Equity income (loss) Paketeria	0	0	263	0	**263**	0	0	0	0	**0**					**0**	**0**
	Equity income (loss) GridSense	(129)	0	0	0	**(129)**	0	0	0	0	**0**					**0**	**0**
	Minority interest	(107)	(37)	96	468	**420**	50	265	373	(26)	**662**	368	200	200	225	**993**	**1,400**
NET INCOME before NRI		(236)	120	(713)	(1,568)	**(2,396)**	(971)	(101)	(2,146)	(4,210)	**(7,428)**	(2,217)	(2,360)	(2,251)	(2,156)	**(8,984)**	**(10,302)**
	Weighted Avg. Shares Out. Diluted	11,535	11,553	11,186	11,592	**11,445**	12,498	15,161	15,721	16,254	**14,910**	17,449	17,798	18,154	18,517	**17,979**	**21,681**
Zacks Diluted EPS before NRI		(0.02)	0.01	(0.06)	(0.14)	**(0.21)**	(0.08)	(0.01)	(0.14)	(0.26)	**(0.50)**	(0.13)	(0.13)	(0.12)	(0.12)	**(0.50)**	**(0.48)**
NRI	ex-Comverge	(417)	(810)	(176)	0	**(1,403)**					**0**						
	Paketeria			(263)		**(263)**					**0**						
	Gain on deconsolidation of Coreworx					**0**				1,834	**1,834**						
	Discontinued ops. (Coreworx)	(827)	224	(512)	(2,219)	**(3,334)**	(2,152)	(3,051)	(2,418)	(11,873)	**(19,494)**						
	Total Non-reoccurring Items (NRI)	(1,244)	(586)	(951)	(2,219)	**(5,000)**	(2,152)	(3,051)	(2,418)	(10,039)	**(17,660)**	0	0	0	0	**0**	**0**
NET INCOME after NRI		(1,480)	(466)	(1,664)	(3,787)	**(7,396)**	(3,123)	(3,152)	(4,564)	(14,249)	**(25,088)**	(2,217)	(2,360)	(2,251)	(2,156)	**(8,984)**	**(10,302)**
NRI per share		(0.11)	(0.05)	(0.09)	(0.19)	**(0.44)**	(0.17)	(0.20)	(0.15)	(0.62)	**(1.18)**	0.00	0.00	0.00	0.00	**0.00**	**0.00**
Diluted EPS after NRI		(0.13)	(0.04)	(0.15)	(0.33)	**(0.65)**	(0.25)	(0.21)	(0.29)	(0.88)	**(1.68)**	(0.13)	(0.13)	(0.12)	(0.12)	**(0.50)**	**(0.48)**

Acorn Energy, Inc.

Income Statement and Balance Sheet

(Dollars in millions, except EPS data)- results prior to 2009 have not been restated to reflect Coreworx sale

	12/06	12/07	12/08	12/09	12/10	12/11E
Sales	4.1	5.6	20.7	27.3	35.7	35.5
Cost of Goods Sold	2.8	4.2	14.2	17.1	22.5	22.9
SG&A	4.6	5.3	11.7	12.0	17.7	20.5
Other operating expenses	0.0	1.6	3.0	0.5	1.1	1.7
Interest and other	0.8	-0.3	5.7	1.3	1.8	0.4
Zacks Adjusted Income before NRI	-4.1	-5.2	-13.9	-2.4	-7.4	-9.0
Net Income	-6.1	32.5	-7.9	-5.8	-25.1	-9.0
Diluted EPS before NRI	-0.48	-0.45	-1.20	-0.21	-0.50	-0.50
Reported EPS	-0.71	3.30	-0.69	-0.50	-1.68	-0.50
Cash & Marketable Securities	1.5	19.6	15.1	10.9	7.4	5.9
Current Assets	3.6	24.7	25.6	24.7	27.8	25.0
Current Liabilities	3.3	10.9	11.8	8.4	13.2	12.8
Long Term Debt	0.0	0.0	0.0	0.4	0.4	0.4
Shareholder's Equity	-0.5	67.3	36.1	36.1	41.9	34.2

HISTORICAL ZACKS RECOMMENDATIONS



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