Zacks Small-Cap Research

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Acorn Energy, Inc. (ACFN-NASDAQ)

ACFN: Sale of CoaLogix provides management with a $60 million war chest to enhance shareholder value.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	08/29/2010
Current Price (11/03/11)	$4.64
Six- Month Target Price	**$6.10**

OUTLOOK

Acorn Energy sold its 65%-owned CoaLogix subsidiary for a fully-priced 4.9 times 12-month trailing sales. The after-tax proceeds are estimated to be approximately $57 million or $3.26 per share. Subsequently, the Board approved both a regular and a special dividend. With approximately $60 million available for investment, management has the capacity to invest in all of the three operating companies and to expand its portfolio of businesses with either a bolt-on acquisition or potentially another operating company. We maintain our Outperform rating and price target of $6.10.

SUMMARY DATA

52-Week High	**$5.72**
52-Week Low	**$3.46**
One-Year Return (%)	**20.52**
Beta	**0.65**
Average Daily Volume (shrs.)	**40,706**
Shares Outstanding (million)	**18**
Market Capitalization ($ mil.)	**$81**
Short Interest Ratio (days)	**1.80**
Institutional Ownership (%)	**22**
Insider Ownership (%)	**7**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**89.0**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/M**
P/E using 2011 Estimate	**2.6**
P/E using 2012 Estimate	**N/M**
Zacks Rank	**3**

Risk Level	**Above Average**
Type of Stock	**Small - Value**
Industry	**Elect. Prods. – Misc.**
Zacks Rank in Industry	**4 of 22**

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	10.7 A	8.6 E	5.7 E	31.9 E
2012					20.0 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	-$0.12 A	$2.05 E	-$0.07 E	$1.81 E
2012					-$0.03 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

- 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 are estimated to be approximately $57 million or $3.26 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. The transaction increased our target to $6.10.
- 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. 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 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**. 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 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 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 includes 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.

In addition to the sale of CoaLogix, the **major drivers in 2011** are expected to be the investment in seismic monitoring products and **additional orders at USSI**, along with the **broadened product line** and improved sales force **at GridSense**. These initiatives were initially funded by the proceeds from the December 2010 secondary offering, which are now augmented by the proceeds from the sale of CoaLogix. With approximately $60 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 are expected to be at least $56.9 million.

Acorn Energy is a member of the Russell Microcap Index.

RECENT NEWS

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** will be paid in January 2012 to shareholders of record on December 30th.

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. Management expects **after-tax proceeds will be at least $56.9 million** or **$3.26 per share**. UBS Investment Bank acted as exclusive financial advisor to CoaLogix.

On August 9, 2011, Acorn Energy reported **second quarter results** for the period ending June 30, 2011. Revenues increased 30.3% to $10.72 million from $8.23 million, primarily due to strong growth at CoaLogix and GridSense, where revenue growth was well above expectations. Total gross profit declined 14.2% to $2.98 million from $3.48 million in the comparable-period last year. The gross profit margin decreased 1,444 basis points (bps) to 27.8% from 42.3%, primarily due to the margin pressures at CoaLogix and DSIT. However, as a result of the implementation of cost controls, including reduced corporate expenses and no 2010 bonuses being awarded, Acorn reported a quarterly loss from continuing operations of $2.08 million or $0.12 per diluted share, which was above our estimate of a loss of $0.14.

Revenues at DSIT declined 11.1% to $2.51 million in the second quarter, primarily due to the delay of a follow-on order of a large expansion project to alter the configuration of the already ordered DDS system. The gross margin declined 1,341 basis points (bps) to 24.1% from 37.5% in the prior sequential quarter due to technological difficulties in non-Naval projects that increased labor costs and a delay on an AquaShield project. For the second half, the growth and the level of profitability are partly dependent upon the receipt of the anticipated follow-up order.

Revenues at GridSense increased 190% year-over-year to $1.50 million from $517 thousand, which were much better than expectations. Revenue growth was driven by a major TransformerIQ monitoring project by a leading southeastern electric utility to deploy at least 750 TransformerIQ's and seasonal strength in Australia where utilities consumed the balance of their annual budget allocations. The gross margin sequentially expanded 631 basis points (bps) to 48.4% from 42.1% in the first quarter as a result of the economies of scale, along with lower production costs on account of shifting production from Australia to

a lower-cost facility in California. The majority of the units for the TransformerIQ monitoring project will be shipped in the second half of 2011.

USSI reported a 209% increase in revenues to $99 thousand, up from $32 thousand in the depressed comparable-period last year. So far in 2011, USSI has received four significant potential 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 18 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. USSI continues to grow its sales pipeline, and management anticipates significant growth in revenues for the balance of 2011 and into 2012.

GridSense™

GridSense updates

On September 1, 2011, GridSense announced the commercial launch of a new version of TransformerIQ that can be installed without shutting off power. The unit is essentially maintenance free since it is environmentally sealed and uses battery-less technology.

On June 2, 2011, GridSense announced that a leading Southeastern electric utility selected TransformerIQ to monitor over 2,000 transformers in a single metropolitan county in its service territory. With the TransformerIQ product being capable of monitoring two-to-three transformers, the announced project is for **750 TransformerIQ**'s, but the order could potentially be expanded by 7%. **The order should generate revenues of over $2.3 million in the third and fourth quarters.** Half the funding for the project is being provided through The American Recovery and Reinvestment Act.

GridSense

Headquartered in Sydney, Australia, GridSense has been expanding its suite of smart monitoring and control systems for electric utilities. GridSense's products address the old and aging electric power delivery system infrastructure of electric utilities, i.e. between the power generation facilities and the end-user. GridSense's product offerings detect and measure critical aspects at vital points along the electricity transmission and distribution systems, namely at substations and transformers, and on distribution and transmission lines. Products include LineTracker overhead line recorders, PowerMonic low voltage power analyzers, TransformerIQ transformer monitors, and LiveLine high voltage inspection cameras.

The TransformerIQ provides real-time monitoring of 28 key parameters related to transformer failure, including operating temperatures, predicted asset life, system capacity, operating current voltage and power factor. With over 30 million pole-top transformers in the United States (each usually servicing three to four homes) at an average age of 42 years, a monitoring system would enable the cost-effective replacement of aging transformers before they breakdown (sometimes by explosion) and cause power disruptions. Transformers were designed for a 30-to-40 year life.

GridSense's transformer monitoring solutions can help extend the lives of $300,000 transformers by measuring real-time load. Transformers on the verge of failure can be replaced prior to failure, while those under manageable stress during times of high demand can have their load reduced by re-routing power to other lines, thereby extending their useful lives.

The project should demonstrate to other electric utilities the value and cost-effectiveness of intelligently monitoring the transformers in the electrical distribution system to improve its reliability by preventing outages.

US Seismic Systems (USSI) updates

On September 16, 2011, USSI introduced a fiber optic ocean bottom cable for 4D marine seismic applications, especially for permanent reservoir monitoring. Currently, enhanced oil recovery techniques require repeated 3D seismic streamer surveys on the same reservoir to monitor existing offshore fields. USSI's 4D product is a cost effective alternative, and this new product spur widespread adoption of permanently-installed seabed cables for 4D seismic data collection.

On September 14, 2011, USSI announced the receipt of a $620,000 order for a high temperature down-hole seismic monitoring system. This is the **fifth significant oilfield application order received in 2011.** USSI's ultra-high-sensitivity fiber optic sensor system has the highest temperature rating of any large-scale production down-hole seismic system, which makes it suitable not only for hydraulic fracturing stimulations but also for geothermal power sources.

On July 6, 2011, US Seismic Systems (USSI) received an order for fiber optic sensors as part of a real-time multi-well Hydraulic Fracture stimulation Mapping (HFM) system offered by Octave Reservoir Technologies. The high temperature, downhole, fracture seismic system monitors the effectiveness of hydraulic fracture stimulation on a time-lapse 4D basis outlining the length, height, azimuth, connectivity and density of the fracture. The order is for an unnamed leading domestic oilfield seismic service company.

Also on July 6, 2011, USSI received an order for custom downhole seismic systems, which are based on the company's fiber optic sensor technology. **The annual value of this contract when in full production is expected to be approximately $6 million**. The high temperature, permanent downhole systems provide high resolution imaging to enhance oil recovery from mature, declining oil fields.

On July 5, 2011, USSI was awarded an order to develop a large-scale, fiber optic sensor technology seismic system for a major oilfield services company. **Once in production, the value of this order is over $10 million annually**. USSI's fiber optic sensors will be permanently embedded in reservoirs and provide real-time information to facilitate yield improvement from reservoir stimulation. Also, USSI has moved into a new 21,000 square foot manufacturing facility in Chatsworth, California and is expanding its staff to accommodate the increased R&D required.

US Seismic Systems, Inc.

Located in Los Angeles, US Sensor Systems designs, manufactures, and sells optical fiber sensing systems to the energy, defense and security markets. The optical sensor technology of USSI's optical fiber has the exciting potential to become an enabling technology for 4D seismic in the exploration and production of oil & gas. The company's top focus is on the opportunities in the shale gas monitoring industry, especially in hydro-frack monitoring. Also, the seismic streamer segment is being targeted, with a testing being conducted in Europe prior to marine assessment onboard a ship. US Sensor Systems has products developed for the defense and security industries, such as its Ultra High Sensitivity (UHS) Tunnel Detection demonstrated to the Department of Homeland Security, U.S. Northern Command, the Army Corps of Engineers and other agencies in May 2011.



DSIT updates

On September 28, 2011, DSIT received two technical awards for the Submarine Tactical Trainer (STT) that was developed for the Israeli navy. The STT project was awarded the 2011 “Prize for Excellence and Creative Thinking” by the IDF Communications and Computer Corps and the “Chief Naval Officer Award” by the Commander of the Israeli Navy. The $8 million simulator project was completed several months ago and provides training for crews of Dolphin submarines by enabling simulated replication of tactical operation of weapon systems, sonar sensors and Command and Control applications.

DSIT Solutions

Based in Givat Shmuel, Israel, DSIT Solutions provides sonar and acoustic-related solutions for port security of strategic energy installations, in addition to related defense and homeland security markets. The flagship product is AquaShield™, a Diver Detection Sonar (DDS) system that provides coastal and offshore protection by detecting and then tracking divers, swimmers, swimmer delivery vehicles, submersibles, and small surface vessels. DSIT’s sonar and acoustic technologies have a myriad of other applications, such as naval radiated noise measurement and sonar training simulation. Other offerings include PortView Harbor Surveillance System (HSS), PointShield™ Portable DDS, Sonar Simulators and Trainers, Mobile Acoustic Ranges (MAR) and Underwater Acoustic Signal Analysis (UASA) systems. In addition other companies are using sonar building blocks built by DSIT in the construction of their own sonar systems.

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, our $6.10 price target is based on the high-end 3.2 price-to-sales ratio valuation on the remaining operations plus the excess cash of $3.32 per share. At $4.64, the current P/S ratio on trailing 12-month sales of Acorn’s remaining three operating companies (ex-cash) is calculated to be 1.52.

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 E	Q4 E	2011 E	2012 E
INCOME STATEMENT (000 except EPS)													
CoaLogix	revenues	**18,099**	4,478	4,855	5,479	6,638	**21,450**	3,747	6,612	3,718	0	**14,077**	**0**
DSIT	revenues	**9,219**	2,507	2,823	3,189	2,843	**11,361**	2,348	2,509	2,810	3,147	**10,814**	**12,112**
GridSense	revenues			517	671	1,194	**2,382**	641	1,499	2,000	2,100	**6,240**	**6,989**
US Sensor	revenues		99	32	160	212	**504**	106	99	114	500	**819**	**942**
TOTAL REVENUES		**27,318**	7,084	8,227	9,499	10,887	**35,697**	6,842	10,719	8,642	5,747	**31,950**	**20,043**
CoaLogix	cost of goods sold	**11,803**	2,546	3,000	4,563	4,224	**14,333**	2,665	4,976	2,798	0	**10,439**	**0**
DSIT	cost of goods sold	**5,264**	1,342	1,558	1,815	1,851	**6,646**	1,467	1,904	2,132	2,388	**7,892**	**7,267**
GridSense	cost of goods sold	**0**		191	321	698	**1,210**	371	773	1,080	1,113	**3,337**	**3,704**
US Sensor	cost of goods sold	**0**	82		84	260	**344**	83	83	87	370	**623**	**706**
TOTAL COST OF GOODS SOLD		**17,067**	3,970	4,749	6,783	7,032	**22,533**	4,586	7,736	6,097	3,871	**22,290**	**11,678**
Gross Profit		**10,252**	3,114	3,478	2,716	3,855	**13,164**	2,256	2,983	2,545	1,876	**9,660**	**8,365**
TOTAL SG&A		**12,028**	4,147	4,662	4,629	4,247	**17,685**	4,558	4,762	4,600	3,000	**16,920**	**9,000**
	R&D expense	**(543)**	(48)	(189)	(282)	(612)	**(1,131)**	(588)	541	(302)	(230)	**(579)**	**(300)**
	Dividends from EnerTech	**0**	135	0	0	0	**135**					**0**	**0**
	Impairments	**(2,692)**	0	0	0	(1,166)	**(1,166)**					**0**	**0**
OPERATING INCOME		**(5,011)**	(946)	(1,373)	(2,195)	(2,171)	**(6,684)**	(2,890)	(2,320)	(2,358)	(1,354)	**(7,840)**	**(935)**
	Interest expense	**(86)**	0	(197)	48	(90)	**(239)**	(122)	(109)	(109)	(109)	**(449)**	**500**
	Gain on Sale CoaLogix	**0**					**0**			43,800		**43,800**	**0**
	Gain on Sale Comverge	**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		**(3,694)**	(946)	(243)	(2,147)	(4,083)	**(7,418)**	(2,520)	(2,429)	41,333	(1,463)	**36,003**	**(435)**
	Taxes	**744**	(75)	(123)	(372)	(101)	**(671)**	(65)	26	(5,113)	(113)	**(5,265)**	**(200)**
Net Income after taxes		**(2,950)**	(1,021)	(366)	(2,519)	(4,184)	**(8,089)**	(2,585)	(2,403)	36,220	(1,576)	**30,738**	**(635)**
	Equity income (loss) Paketeria	**263**	0	0	0	0	**0**					**0**	**0**
	Equity income (loss) GridSense	**(129)**	0	0	0	0	**0**					**0**	**0**
	Minority interest	**420**	50	265	373	(26)	**662**	368	324	300	300	**1,292**	**1,200**
NET INCOME before NRI		**(2,396)**	(971)	(101)	(2,146)	(4,210)	**(7,428)**	(2,217)	(2,079)	36,520	(1,276)	**32,030**	**(635)**
	Weighted Avg. Shares Out. Diluted	**11,445**	12,498	15,161	15,721	16,254	**14,910**	17,449	17,489	17,839	18,196	**17,743**	**21,114**
Zacks Diluted EPS before NRI		**(0.21)**	(0.08)	(0.01)	(0.14)	(0.26)	**(0.50)**	(0.13)	(0.12)	2.05	(0.07)	**1.81**	**(0.03)**

HISTORICAL ZACKS RECOMMENDATIONS



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