ENERGY RECOVERY
Third Quarter 2024
Earnings Call
October 30, 2024

Opening Remarks – Lionel McBee

Good afternoon, everyone. Welcome to Energy Recovery's 2024 third quarter earnings conference call. We appreciate your joining us. I am Lionel McBee, Director of Investor Relations at Energy Recovery and I am joined by our President and Chief Executive Officer, David Moon, and our Chief Financial Officer, Mike Mancini.

The prerecorded remarks from today's call are available on the Investors section of our website and are meant to accompany the third-quarter earnings news release, which is posted in the same location.

During today's call, we may make projections and other forward-looking statements under the Safe Harbor provisions contained in the Private Securities Litigation Reform Act of 1995 regarding future events or the future financial performance of the Company. These statements may discuss our business, economic and market outlook, growth expectations, new products and their performance, cost structure, and business strategy. Forward-looking statements are based on information currently available to us and on management's beliefs, assumptions, estimates, or projections.

Forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties, and other factors.

We refer you to documents the Company files from time to time with the SEC, specifically the Company's Form 10-K and Form 10-Q. These documents identify important factors that could cause actual results to differ materially from those contained in our projections or forward-looking statements.

All statements made during this call are made only as of today, October 30th, 2024, and the company expressly disclaims any intent or obligation to update any forward-

looking statements made during this call to reflect subsequent events or circumstances, unless otherwise required by law.

And lastly, for your planning purposes, please note that our fourth-quarter and full-year earnings conference call is scheduled for Wednesday, February 26, 2025.

And with that, I will now turn the call over to David.

Strategic and Commercial Update – David Moon

Thanks Lionel and thank you all for joining us today.

As Lionel mentioned, we are joined today for the first time on our quarterly earnings call by Energy Recovery's new CFO, Mike Mancini, who started on August 5th. I want to say how grateful I am for Mike's partnership and the work he has already done. As I mentioned last quarter, Mike brings a wealth of experience in high-growth engineering and technology companies. He has had executive leadership roles in finance, where he demonstrated his ability to drive financial strategy and performance across the entire enterprise. Additionally, his background with the institutional investment community provides him with a deep understanding of capital markets, which makes him a valuable asset to our leadership team. Before I get into the third quarter financial results, I will make a brief comment on our strategic planning process, or the Playbook as we call it. Although we won't be getting into any of the specifics of the Playbook on this call, we are hosting a live investor webinar on November 18th, where members of my senior leadership team will present our Playbook including growth plans for Desalination, Wastewater, and CO2. We will also roll out our guidance for 2025 and 2026, as well as provide long-term 2029 financial targets. The webinar will take place at 10 a.m. Eastern Time and will last approximately two hours, including a live Q&A session.

The event will be accessible virtually via the link located on the IR Calendar section of Energy Recovery's IR website, and a replay of the event will also be archived there. Additional details can be found in our press release issued on October 21st.

Now, let us move to the third quarter update.

Summary – David Moon

First, let me start by saying thank you to our employees for helping to deliver another very solid quarter. The third quarter was strong. With total revenue of $38.6 million, we achieved the upper end of our guidance for the quarter and set another quarterly revenue record. While we still have considerable work to do to deliver what stands to be the largest quarter in the company's history in the fourth quarter, our third quarter performance did create a line of sight to achievement of our full-year guidance of $140 to $150 million.

As I have said the last couple of quarters, the demands on the team to deliver on some of these mega projects are only increasing. With that said, I remain confident in our ability to deliver what will be the biggest quarter in Energy Recovery's history, capping off what will be the eleventh consecutive year of revenue growth and another year of dominant market share in our mega projects channel.

Let me talk briefly about our high-level segment results before turning it over to Mike for the financial details.

Water – David Moon

Beginning with our Water business, Water revenue came in at $38.3 million, an increase of 4% compared to the third quarter of 2023 and up 42% when compared to the second quarter of 2024. This reflects the high end of our guidance for the third quarter of $35 to $39 million and continues the prior quarter's solid growth in mega projects. Results were driven by continued, strong demand in the Middle East and North Africa region, as well as demand from India.

I'd like to highlight several notable desal shipments made during the quarter.

First, we completed the second and final shipment of the Perur project in Chennai, India, worth $4.1 million, as we mentioned previously during our July earnings call. Once constructed, this will be the largest desalination plant in India delivering 400,000 cubic meters per day.

Also, as a reminder, the Perur project in Chennai, India, was just one of the projects included in the $15 million in contracts that we announced in July for several SWRO desalination plants in India. For the remaining four projects under these contracts, we shipped $8.3 million and expect to complete the additional $2.6 million of shipments in the fourth quarter. All together, these plants will provide over 670,000 cubic meters of clean drinking water to communities in India each day.

We also made progress on the Hassyan IPP project in Dubai, UAE during the third quarter, which once constructed will be the largest desalination plant in Dubai providing 820,000 cubic meters per day. As of our last earnings call in July, we had shipped the first phase. As of today, I'm pleased to report that we shipped a total of $10.5 million year-to-date and expect to ship an additional $5.3 million in Q4.

In addition to these shipments, we also continued to secure major desalination contracts in recent months.

In August, we signed contracts totaling $27.5 million for SWRO desalination projects in Morocco. These projects will supply over one million cubic meters per day of potable water for municipal and agricultural use, which represents enough water for more than 600,000 Moroccans. As of today, we have shipped $12.3 million of the total order. The balance of the order is currently expected to be fulfilled in 2024, however we are closely monitoring this timing, given an end-of-December target shipping date. North Africa continues to be an important driver of growth for our water business, with secular trends such as ongoing drought, industrial growth, and population growth continuing to generate strong demand for SWRO desalination plants.

Earlier this month, we announced contract awards totaling over $12 million for three SWRO desalination projects in the United Arab Emirates. The plants include capacity totaling close to one million cubic meters per day, and as a proof point as to the manufacturing improvements we have made, our intent is to ship nearly all of these orders here in the fourth quarter.

Both contract awards, and their shipment dates, were on our radar and therefore included in our financial guidance for 2024.

Based on our strong third quarter results and our expectations for additional shipments in the fourth quarter, we are maintaining our revenue guidance of $140 to $150 million for the year.

As we have provided in previous quarters, our current 2024 total Water revenue as of the end of the third quarter, which includes revenue recognized in the first nine months of the year and signed projects under contract yet to be delivered, totals approximately $137 million or 94% of the midpoint of our guided range for 2024. This compares to roughly $136 million, or 100% of the guided range at the same time in 2023.

While this substantial progress toward our full year guidance underpins our confidence in reaffirming our guided range for the full year, we cannot control customer-driven delays or slippage. With that said, we continue to collaborate closely with our customers, and we remain focused on strong execution in the fourth quarter to complete our remaining shipments and to deliver our full year guidance. In the event unforeseen circumstances cause slippage toward the end of the year, however, I'd like to reiterate that the associated revenue would not be at risk but would simply be recognized in 2025 rather than the fourth quarter of 2024.

Turning to wastewater, our wastewater pipeline continues to grow, and we have increased our signed wastewater contracts by almost 46% as compared to last year during the same period. Our strategic diversification strategy for wastewater is underway, and we are making progress on our product portfolio expansion. For the full year, we expect to generate revenue toward the lower-end of our previously provided guidance range of $12 to $15 million. This is primarily the result of a wastewater mega project, the NEOM project in Saudi Arabia that has transitioned to a longer-term, phased project over multiple years. However, we expect to offset this impact through continued outperformance that we are seeing in the OEM channel. We will share more details on our progress and strategy for Wastewater during our investor webinar on November 18th.

Overall, we feel that the air pocket created by rapidly rising interest rates, inflationary effects, and concerns around global economic activity have begun to

moderate. Clearly, there are still economic and geopolitical concerns around the globe, but the long-term trends for fresh water demand remain intact, and we continue to see solid growth ahead.

Now let's move to our CO2 business.

CO2 – David Moon

We continue to make progress in the development and commercialization of our second generation PX G. As I stated during our last call, in the second quarter we completed our first gating item for 2024, which was the successful completion of lab testing. During the third quarter, we turned our focus to our second gating item, which is the installation of 30 to 50 sites by the end of Q4 2024.

I'm pleased to report that we reached our initial goal of having at least 10 sites installed and operating across the US and Europe. In fact, we have now completed the installation of a total of 11 sites year-to-date.

With the site goal reached, we were able to complete the collection of critical summer data. As I discussed during our last call, we partnered with DC Engineering, a highly respected third-party engineering firm, to measure and verify energy savings provided by our second generation PX G at six of the ten initial sites.

I'm pleased to report that in collaboration with DC Engineering, we recently published the white paper on these results, which we believe will be the catalyst for our OEM partners and for us to accelerate PX G adoption with end users in the near-term. The full white paper can be found on our website, but the results were better than expected, showing that the PX G reduces energy consumption, increases cooling capacity, and improves system stability.

The findings showed that the PX G improved the leading metric of energy efficiency, the coefficient of performance, by peaks of up to 30% with as much as 15% in projected annual energy savings. In addition to energy efficiency, findings estimate the PX G increases cooling capacity for CO2 refrigeration systems by up to 15% at 95°F, or 35°C, providing operational flexibility to safeguard against heatwaves. Based on the success of

the ongoing measurement and verification processes, during the third quarter multiple OEMs began the process of integrating the PX G into their CO2 transcritical racks. This is a necessary and important step towards full commercialization of the PX G. We are highly encouraged by the test results and the resulting integration by our OEM partners.

Adding to our momentum, we currently have 19 additional sites to be commissioned for installation in the coming months. Including the 11 sites already installed and operating, we are on a clear path toward meeting the low end our target of 30 to 50 sites installed by the end of 2024. Additionally, our pipeline of additional sites has grown meaningfully as the industry gained awareness of the PX G technology. We are in discussions with existing customers to expand installed sites and with new OEM and end-customer parties for new sites across the U.S. and Europe. Momentum for the PX G is clearly accelerating.

I look forward to sharing additional details on our progress and strategy for CO2 and wastewater during our upcoming webinar.

With that, I would like to hand it over to Mike to discuss our financial results for the quarter.

Financial Update – Mike Mancini

Thank you, David. And, let me start by saying thanks to you and to the Board for your trust and confidence in me to lead the finance function here at Energy Recovery. Before arriving, I was excited about the company's core business prospects, the exciting opportunities to grow and expand the reach of the PX technology, and the opportunity to drive profitability and cash flow. After almost three months on the job, I am now confident in the company's ability to create value for its shareholders and I look forward to working with the team on driving financial results.

I'd like to begin by discussing our Revenue, Gross Margin and product mix. Then, I'll discuss our Operating Expense, Net Income, and cash position, as well as our expectations for the full year 2024.

As David mentioned we had a solid quarter of revenue, generating $38.6 million, at the upper end of our guidance. The project-driven, lumpy-nature, of our megaproject channel has become quite evident to me even in the short time I have been here. Q4 revenue is expected to be between $62 million and $72 million, which will represent over 45% of our full-year revenue at the midpoint. In the 4th quarter alone, five projects represent approximately 50% of the revenue, with a single project representing over 20%. Any delays in shipment dates on those projects would have an impact on our full-year revenue, although there would be a minimal impact to the intrinsic value of the business of such delays.

Moving to Margins. Our Gross Margin improved 50 basis points when compared to the second quarter of the year, with the third quarter coming in at 65.1%, above our previously guided range of 62% to 64% for the third quarter. We believe we have turned the corner in our efforts to manage and resolve challenges related to our ramp up in production for the Q400, and our Gross Margin expectation for the fourth quarter is 64% to 68%, which would put our full year Gross Margin guidance within our guided range of 64% and 67%

Regarding product mix, on our last call we stated that the Q400 was trending towards 50% of our Water PX demand for 2024, up from our original expectation of 25%.

During the third quarter, the Q400 comprised approximately 45% of our Water PX demand, reinforcing our expectation for 50% product mix for the full year. This faster-than expected-adoption of the Q400 highlights our product leadership position in the megaproject desalination space and underscores our ability to align our solutions with customers' evolving needs.

Our Operating Expenses for the third quarter were $18.1 million, which came in below our previously guided range of $21 to $22 million for the quarter. One-time costs for the quarter were $1.1 million. As a result, Base Opex for the quarter was $17 million, a 1% increase from the same period last year. So, while our focus on cost and capital efficiency are working, we do expect to continue to experience some one-time costs associated with the work in support of our long-term growth strategy and some added employee count to support our growth. Still, we will be able to capture the benefit of our cost efforts and are reducing our full year Operating Expense guidance to $76 to $78 million from the previous $78 to $80 million, which still includes the estimated $7 million in one-time costs we have indicated before. This implies expected Operating Expense for the fourth quarter of approximately $20 to $22 million and full year 2024 Base Opex of $69 to $71 million.

Additionally, we reported Income from Operations for the third quarter of $7.1 million, in line with our expectation provided on our last call to move to positive operating income as the year progresses. We also reported Net Income for the third quarter of $8.5 million, reflecting a substantial increase compared to the second quarter.

Lastly, we maintained our cash balance during the quarter, with cash and investments of $139.9 million as of the end of the third quarter compared to $138 million at the end of the second quarter. We remain in a very strong financial position and we expect to end the year at between $140 to $150 million of cash, depending on collections.

With that, I'd like to turn it back over to David for a few closing remarks.

Wrap-Up – David Moon

Thank you, Mike.

To sum up:

- We delivered a record third quarter, and while there is still work ahead of us to execute the fourth quarter, we remain confident in our full year revenue guidance of $140 to $150 million,
- We remain on track to generate $12 to $15 million in revenue from our wastewater business, although we anticipate this will come in toward the lower end of the range,
- We are on track to deliver the low end of 30 to 50 sites with our second generation PX G installed by the end of the year.We are maintaining our Gross Margin guidance of 64% to 67%.
- We are reducing our Operating Expense guidance to $76 to $78 million.

With that, let’s move to Q&A.