ERII Q4 2024 Letter to Shareholders

Fellow Shareholders,

- In 2024 we set the foundation for long-term revenue, profit, and cash flow growth.
  - We made significant progress in our PX® Pressure Exchanger® ("PX") diversification efforts, growing wastewater revenue by 85% and achieving key milestones in our CO_2 business.
  - We revamped the executive team, hiring a new Chief Financial Officer, Vice President, CO_2, and Vice President, Operations and appointed the Company's first Chief Human Resources Officer.
  - We established our 2025-2029 strategic operating plan, which we shared in our November investor presentation, with clear milestones, goals, and accountability to drive meaningful results.
  - We implemented a restructuring plan to lower our operating cost structure and initiated a manufacturing transformation to drive margin improvement through production efficiency.
  - We established a capital allocation strategy and repurchased 3.2 million shares of outstanding common stock for a total cost of $50 million.
- 2024 results reflect these efforts, delivering revenue at the midpoint of guidance, gross margin at the top of guidance, and Adjusted EBITDA(1) that beat expectations.
  - Revenue of $144.9 million, representing 13% growth over 2023 and the midpoint of our $140 to $150 million guidance.
  - Gross margin of 66.9%, at the high end of the 64% to 67% guidance due to strong Q4 gross margin performance.
  - Operating expenses ("Opex") of $77.2 million was at the midpoint of our $76 to $78 million guidance, but expenses excluding restructuring costs and executive transition costs were better than expected.
  - Net income of $23.1 million, representing 7% growth over 2023, and Adjusted EBITDA of $42.0 million, representing 35% growth over 2023, and better than expectations.
- For 2025, we are increasing our gross margin guidance and improving our Opex guidance given the out performance in Q4, and reaffirming our revenue guidance.

Strategic Plan Recap

In November, we shared our 5-year strategic roadmap for disciplined, profitable growth. 2025 is the first full year of executing against that plan and we remain committed to the strategy and are excited for the future. Underlying the strategy is our focus on three core markets:

- Desalination, where long-term growth is underpinned by our projected ~$550 million megaproject ("MPD") pipeline
- Wastewater, where the PX can address market verticals with an annual total addressable market ("TAM") nearly as large as desalination
- CO_2, where we are targeting 65,000 supermarkets across the U.S. and Europe as they upgrade or replace their refrigeration systems, and are exploring large adjacent markets like heat pumps and data centers

We are also laser focused on efficient capital allocation, driving manufacturing and operational cost improvements and returning excess cash to shareholders.

(1) Refer to the sections "Use of Non-GAAP Financial Measures" and "Reconciliation of Non-GAAP Financial Measures" or definitions of our non-GAAP financial measures and reconciliations of GAAP to non-GAAP amounts, respectively

Q4 results

Total revenue of $67.1 million in Q4 2024 increased 17% over the fourth quarter of 2023. Revenue was at the midpoint of the range implied by our full year 2024 guidance despite the risks of timing delays highlighted during our October earnings conference call. All major contracts were shipped in December, with no significant project slippage.

Gross margin in the fourth quarter of 70.2% surpassed our expectations of 64% to 68%. Our manufacturing transformation is well underway. The combination of experienced manufacturing executives and lean process improvements has allowed us to achieve some of our anticipated manufacturing efficiencies faster than expected. The full year 2024 gross margin of 66.9% puts us on track to achieve our long-term gross margin targets.

Operating expenses for the fourth quarter totaled $21.5 million compared with guidance of $20 to $22 million. Of note, operating costs for the period included executive transition costs of $0.1 million and restructuring costs due to our announced workforce reduction of $2.5 million. Our operating expenses excluding these costs came in lower than expected as our cost-reduction efforts took hold. We have successfully reset our operating costs and will maintain a lean operating infrastructure going forward.

Net income for the quarter totaled $23.5 million, bringing full year net income to $23.1 million, or 16% of total revenue. Adjusted EBITDA for the quarter totaled $31.3 million, bringing full year Adjusted EBITDA to $42.0 million, or 29% of total revenue.

Our net income per share and our adjusted net income per share(1) of $0.41 and $0.50, respectively, for the fourth quarter benefited from strong operating results, as well as a decreased share count.

The $50.0 million share repurchase program we announced in November was completed during the quarter. In total, we repurchased 3.2 million shares for an average price of $15.37 per share.

Water Business

Continuing a decade-long run of top line revenue growth, our Water segment delivered record breaking revenue for the quarter and for the year. Fourth quarter revenue of $67.0 million increased 17% over the fourth quarter of 2023 and full year 2024 revenue of $144.3 million increased 13% over 2023. These results were at the midpoint of our guidance range of $140 to $150 million for the full year.

Our desalination business (part of our Water segment) delivered revenue in-line with the guidance. Strong performance during the fourth quarter was driven by the execution of several large projects that we discussed in our October earnings call, including the Hassyan IPP project in Dubai, United Arab Emirates, and multiple projects in Morocco, highlighting the continued strength in the GCC and increasing MPD activity in North Africa. These projects collectively accounted for about 30% of our fourth quarter revenue. The team did an incredible job of delivering on a demanding timeframe, and all major projects were shipped within the year.

The Q400 PX ("Q400") continued its successful adoption by the market in the fourth quarter. Launched in the fourth quarter of 2022, the Q400 accounted for over 60% of PX units sold during the quarter, and over 50% of our total PX units shipped for the full year. The faster-than-expected adoption of the Q400, our most efficient, highest-capacity PX, highlights Energy Recovery's ability to meet the market's demand for innovation, and we expect the fourth quarter's product mix to continue for 2025.

The Q400 production issues we experienced early in the year are behind us, and we are now on track for our goal of a 10% annual decrease in Q400 costs, as set out in our 2025-2029 strategic operating plan. In the fourth quarter of 2024 alone, unit cost reduced more than 5% as compared to the third quarter, driving our strong gross margin performance.

Looking ahead, our projected ~$550 million MPD project pipeline continues to be our largest 5-year pipeline in history, with positive demand trends for fresh water. North Africa continues to grow in importance, which helps diversify from our traditional Middle East concentration. For 2025, we maintain our 2025 desalination revenue guidance of $138 to $145 million. We expect the quarterly revenue trend in 2025 to be similar to 2024, with a meaningful portion of our revenue occurring in the second half of the year.

Our wastewater business (also part of our Water segment) achieved strong year-over-year quarterly growth with $7.3 million of revenue in the fourth quarter of 2024, a 114% increase over the fourth quarter of 2023. Full-year revenue of $12.6 million represented 85% growth over 2023. Growth is coming from all of the primary verticals discussed in our strategic plan. Of note, we recently published a case study on how the PX reduced cost at a nanofiltration-based lithium extraction facility in China, which highlights a key growth vertical for the business line. Stepping back, our wastewater business has grown from zero revenue in 2020 to contributing 9% of of our total revenue in 2024.

Today we are excited to announce the appointment of David Kim-Hak as our Vice President, Wastewater, reporting to the CEO. David's deep water industry expertise along with product development experience will help drive our target revenue growth in the vertical. He will be focused on the continued build-out of a dedicated sales team, which is already underway, and on rounding out our product portfolio.

Given the momentum and trends, we are maintaining our 2025 wastewater guidance of $13 to $16 million. Note that we are monitoring the impacts of potential additional global tariff and trade policies, especially as they relate to our wastewater PX exports to China, and will provide updates as the situation evolves.

Our expected Water segment (desalination and wastewater combined) growth for 2025 is based on continued strong underlying trends for clean, fresh water. Our solid pipeline supports our 2025 revenue guidance, and the robust MPD project pipeline aligns to our long-term targets.

CO_2 Business

Our CO_2 business momentum continues to build. For the year, we successfully delivered the PX G1300® (also referred to as "PX G") units required to commission our minimum goal of 30, although approximately half of these sites were not yet fully commissioned as of year-end.

We are making steady traction moving original equipment manufacturers ("OEMs") through the commercialization process we outlined in November. Multiple OEMs are working with us to integrate the PX G into their refrigeration rack designs. Importantly, one OEM has already completed the integration design work and is moving to the end user pilot test phase. We are also beginning to engage in contractual discussions with key OEMs in parallel with design work and field trials.

This is a cautious industry, and OEMs are taking time to validate the PX G's value proposition. We have thus far seen an encouraging reaction to our published whitepaper and case studies, with customers responding favorably to the PX G's ability to save energy, increase refrigeration system capacity, and save water via reduced evaporative cooling system use. The upcoming summer season will be very important as our customers run field trials of integrated PX Gs to confirm these benefits and move towards broad commercial adoption.

Interestingly, we are seeing increased activity from customers outside of our core focus areas of the United States ("U.S.") and Europe as the industry learns more about the benefits of the PX G. While regulations discouraging the use of hydrofluorocarbons in refrigeration differ by geography, the global market as a whole is trending towards adoption of CO_2 as a refrigerant. Should regions outside of our core focus areas adopt the PX G, we see a potentially meaningful TAM increase beyond what we communicated in November.

Based on our current pipeline and discussions with OEMs and end users, we reaffirm our stated revenue guidance of $1 to $3 million for the year.

We are also digging deeper into the heat pump and data center markets. We will update you on our findings according to the milestones laid out in our 2025-2029 strategic operating plan.

2025 Outlook

Energy Recovery enters 2025 focused on executing both our growth plan and manufacturing transformation. We are maintaining our 2025 revenue expectations of $152 to $164 million, including desalination revenue of $138 to $145 million, wastewater revenue of $13 to $16 million and CO_2 revenue of $1 to $3 million. Please note that our guidance this year is focused only on annual targets, which more closely aligns with how we run the business.

Reflecting the early success of our manufacturing transformation, we are increasingly confident in our gross margin improvement trends. As such, we are increasing 2025 gross margin expectations to 66% to 68% from the prior target of 65% to 68%

After a thorough review, we also expect operating expenses to remain controlled at $70 to $73 million, lower than our earlier estimate of $70 to $74 million. We are re-investing the cost savings from the restructuring into growth verticals of wastewater and CO_2 as well as on some one-time projects supporting the manufacturing transformation, in line with our focus on driving organic growth.

Recent U.S. policy changes regarding tariffs and trade are top of mind for Energy Recovery. We believe we can navigate the issue, as we did in 2018 given a relatively small portion of our PX costs are imported goods, the majority of our sales are made outside the U.S., and we have decades of experience working with our largest customers and suppliers. Our guidance assumes the continuation of the policies that are in place today, and we will continue to monitor changes as they occur.

The table below summarizes our 2025 guidance.

	Low	High
	(in millions, except percentages)	
Revenue:		
Desalination	$ 138.0	$ 145.0
Wastewater	13.0	16.0
CO_2	1.0	3.0
Total Revenue	$ 152.0	$ 164.0
Gross Margin	66.0 %	68.0 %
Operating Expenses	$ 70.0	$ 73.0
Stock-based Compensation	$ 8.0	$ 10.0
Depreciation and Amortization	$ 3.5	$ 4.5
Capital Expenditures	$ 3.0	$ 4.0

Share Repurchase Update

Finally, we have a clear sense of the capital required to fund our growth and transformation in 2025 and can provide shareholders with strong business growth as well as cash generation. Today, we announced the authorization of a share repurchase plan to purchase up to $30 million of outstanding common stock over the next 12 months. This is in addition to the Q4 share repurchase of $50 million that was authorized and fully completed in Q4 last year.

Message from the CEO

I'd like to take a moment to thank our retiring Chief Technology Officer, Farshad Ghasripoor, for his contributions to Energy Recovery during his tenure. Under Farshad's leadership, this company designed, refined and commercialized the first-ever PX for CO_2 and the Q400, which represents a next-generation improvement on the desalination industry-standard PX Q300. Farshad indicated to me in Q4 that he was contemplating retirement, and together we began to search for his potential replacement. Upon finding the right candidate, Farshad decided to officially retire and hand the reins over to Ram Ramanan, as you have seen in our press release today.

I've recently passed my one-year mark with Energy Recovery and am proud of what we achieved in 2024. I also feel strongly that we have the right team, the right strategy, and the right discipline in place to deliver a successful 2025 and beyond. I'd like to thank our employees for delivering strong results in 2024 and for their energy and enthusiasm for the future of our company.

Again, thank you to all our shareholders for the continued support, and we look forward to hosting a Q&A.

Financial Highlights

	Quarter-to-Date			Year to Date		
	Q4'2024	Q4'2023	vs. Q4'2023	2024	2023	2024 vs. 2023
	(In millions, except net income per share, percentages and basis points)					
Revenue	$67.1	$57.2	up 17%	$144.9	$128.3	up 13%
Gross margin	70.2%	69.1%	up 110 bps	66.9%	67.8%	down 90 bps
Operating margin	38.2%	36.0%	up 220 bps	13.6%	14.8%	down 120 bps
Net income	$23.5	$19.8	up 19%	$23.1	$21.5	up 7%
Net income per share	$0.41	$0.34	up $0.07	$0.40	$0.37	up $0.03
Effective tax rate				10.4%	5.3%	
Cash provided by operations	$9.0	$13.8		$20.5	$26.1	

Non-GAAP Financial Highlights [1]

	Quarter-to-Date			Year to Date		
	Q4'2024	Q4'2023	vs. Q4'2023	2024	2023	2024 vs. 2023
	(In millions, except adjusted net income per share, percentages and basis points)					
Adjusted operating margin	45.2%	39.9%	up 530 bps	26.2%	21.1%	up 510 bps
Adjusted net income	$28.3	$22.0	up 29%	$40.7	$28.9	up 41%
Adjusted net income per share	$0.50	$0.39	up $0.11	$0.71	$0.51	up $0.20
Adjusted EBITDA	$31.3	$23.9		$42.0	$31.2	
Free cash flow	$8.9	$12.4		$19.2	$23.5	

(1) Refer to the sections "Use of Non-GAAP Financial Measures" and "Reconciliation of Non-GAAP Financial Measures" for definitions of our non-GAAP financial measures and reconciliations of GAAP to non-GAAP amounts, respectively.

Forward-Looking Statements

Certain matters discussed herein and on the conference call are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including our guidance on future financial achievement; our projection of the $550 million MPD pipeline and our ability to capture a meaningful portion of such pipeline; our belief that the wastewater markets have a TAM as large as desalination, and that our PX can unlock such TAM; our belief that our manufacturing transformation puts us on track to achieve the long-term gross margin targets; our expectation that the Company's Q4's product mix will continue for 2025; our belief that we are on track for a 10% annual decrease in Q400 costs; and our belief that the North Africa region will continue to grow in importance in desalination. These forward-looking statements are based on information currently available to the Company and on management's beliefs, assumptions, estimates, or projections and are not guarantees of future events or results. Potential risks and uncertainties include risks relating to the future demand for the Company's products, risks relating to performance by our customers and third-party partners, risks relating to the timing of revenue, and any other factors that may have been discussed herein regarding the risks and uncertainties of the Company's business, and the risks discussed under "Risk Factors" in the Company's Form 10-K filed with the U.S. Securities and Exchange Commission ("SEC") for the year ended December 31, 2023, as well as other reports filed by the Company with the SEC from time to time. Because such forward-looking statements involve risks and uncertainties, the Company's actual results may differ materially from the predictions in these forward-looking statements. All forward-looking statements are made as of today, and the Company assumes no obligation to update such statements.

Use of Non-GAAP Financial Measures

This document includes certain non-GAAP financial measures, including adjusted operating margin, adjusted net income, adjusted net income per share, adjusted EBITDA and free cash flow. Generally, a non-GAAP financial measure is a numerical measure of a company's performance, financial position, or cash flows that either exclude or include amounts that are not normally excluded or included in the most directly comparable measure calculated and presented in accordance with generally accepted accounting principles in the United States of America, or GAAP. These non-GAAP financial measures do not reflect a comprehensive system of accounting, differ from GAAP measures with the same captions, and may differ from non-GAAP financial measures with the same or similar captions that are used by other companies. As such, these non-GAAP measures should be considered as a supplement to, and not as a substitute for, or superior to, financial measures calculated in accordance with GAAP. The Company uses these non-GAAP financial measures to analyze its operating performance and future prospects, develop internal budgets and financial goals, and to facilitate period-to-period comparisons. The Company believes these non-GAAP financial measures reflect an additional way of viewing aspects of its operations that, when viewed with its GAAP results, provide a more complete understanding of factors and trends affecting its business.

Notes to the Financial Results

- *Adjusted operating margin* is a non-GAAP financial measure that the Company defines as income from operations which excludes i) stock-based compensation; ii) executive transition costs, such as executive search costs, retention costs, one-time severance costs and one-time corporate growth strategy costs; and iii) restructuring charges, divided by revenues.
- *Adjusted net income* is a non-GAAP financial measure that the Company defines as net income which excludes i) stock-based compensation; ii) executive transition costs; iii) restructuring charges; and iv) the applicable tax effect of the excluded items including the stock-based compensation discrete tax item.
- *Adjusted net income per share* is a non-GAAP financial measure that the Company defines as net income, which excludes i) stock-based compensation; ii) executive transition costs; iii) restructuring charges; and iv) the applicable tax effect of the excluded items including the stock-based compensation discrete tax item, divided by basic shares outstanding.
- *Adjusted EBITDA* is a non-GAAP financial measure that the Company defines as net income which excludes i) depreciation and amortization; ii) stock-based compensation; iii) executive transition costs; iv) restructuring charges; v) other income, net, such as interest income and other non-operating income (expense), net; and vi) provision for income taxes.
- *Free cash flow* is a non-GAAP financial measure that the Company defines as net cash provided by operating activities less capital expenditures.

Disclosure Information

Energy Recovery uses the investor relations section on its website as means of complying with its disclosure obligations under Regulation FD. Accordingly, investors should monitor Energy Recovery's investor relations website in addition to following Energy Recovery's press releases, SEC filings, and public conference calls and webcasts.

ENERGY RECOVERY, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	December 31, 2024	December 31, 2023
	(In thousands)	
ASSETS		
Cash, cash equivalents and investments	$ 99,851	$ 122,375
Accounts receivable and contract assets	66,842	47,529
Inventories, net	24,906	26,149
Prepaid expenses and other assets	3,889	3,251
Property, equipment and operating leases	25,119	30,168
Goodwill	12,790	12,790
Deferred tax assets and other assets	9,395	10,712
TOTAL ASSETS	**$ 242,792**	**$ 252,974**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Accounts payable, accrued expenses, and other liabilities, current	$ 20,837	$ 18,583
Contract liabilities and other liabilities, non-current	628	1,304
Lease liabilities	11,317	13,279
Total liabilities	**32,782**	**33,166**
Stockholders' equity	**210,010**	**219,808**
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 242,792**	**$ 252,974**

ENERGY RECOVERY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended December 31,		Years Ended December 31,	
	2024	2023	2024	2023
	(In thousands, except per share data)			
Revenue	**$ 67,075**	**$ 57,189**	**$ 144,948**	**$ 128,349**
Cost of revenue	19,955	17,690	48,015	41,270
Gross profit	**47,120**	**39,499**	**96,933**	**87,079**
Operating expenses				
General and administrative	8,303	7,160	33,074	28,864
Sales and marketing	6,754	6,767	25,423	22,164
Research and development	3,972	4,958	16,236	17,001
Restructuring charges	2,476	—	2,476	—
Total operating expenses	**21,505**	**18,885**	**77,209**	**68,029**
Income from operations	**25,615**	**20,614**	**19,724**	**19,050**
Other income, net	1,240	1,298	6,011	3,655
Income before income taxes	**26,855**	**21,912**	**25,735**	**22,705**
Provision for income taxes	3,384	2,107	2,685	1,201
Net income	**$ 23,471**	**$ 19,805**	**$ 23,050**	**$ 21,504**
Net income per share				
Basic	$ 0.41	$ 0.35	$ 0.40	$ 0.38
Diluted	$ 0.41	$ 0.34	$ 0.40	$ 0.37
Number of shares used in per share calculations				
Basic	56,629	56,735	57,213	56,444
Diluted	57,236	57,671	57,822	57,740

ENERGY RECOVERY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Years Ended December 31,	
	2024	**2023**
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 23,050	$ 21,504
Non-cash adjustments	16,214	13,889
Net cash used in operating assets and liabilities	(18,742)	(9,339)
Net cash provided by operating activities	**20,522**	**26,054**
Cash flows from investing activities:		
Net investment in marketable securities	(14,489)	(16,634)
Capital expenditures	(1,298)	(2,567)
Proceeds from sales of fixed assets	133	87
Net cash used in investing activities	**(15,654)**	**(19,114)**
Cash flows from financing activities:		
Net proceeds from issuance of common stock	7,100	4,794
Repurchase of common stock	(50,384)	—
Net cash (used in) provided by financing activities	**(43,284)**	**4,794**
Effect of exchange rate differences	(52)	33
Net change in cash, cash equivalents and restricted cash	**$ (38,468)**	**$ 11,767**
Cash, cash equivalents and restricted cash, end of year	**$ 29,757**	**$ 68,225**

ENERGY RECOVERY, INC.
RECONCILIATION OF NON-GAAP FINANCIAL MEASURES [1]
(Unaudited)

This press release includes certain non-GAAP financial information because we plan and manage our business using such information. The following table reconciles the GAAP financial information to the non-GAAP financial information.

	Quarter-to-Date		Year to Date	
	Q4'2024	Q4'2023	2024	2023
	(In millions, except shares, per share and percentages)			
Operating margin	**38.2 %**	**36.0 %**	**13.6 %**	**14.8 %**
Stock-based compensation	2.7	3.9	7.1	6.3
Executive transition costs	0.7	—	3.7	—
Restructuring charges	3.7	—	1.7	—
Adjusted operating margin	**45.2 %**	**39.9 %**	**26.2 %**	**21.1 %**
Net income	**$ 23.5**	**$ 19.8**	**$ 23.1**	**$ 21.5**
Stock-based compensation	1.8	2.2	10.3	8.0
Executive transition costs [2]	0.4	—	4.8	—
Restructuring charges [2]	2.2	—	2.2	—
Stock-based compensation discrete tax item	0.4	—	0.3	(0.7)
Adjusted net income	**$ 28.3**	**$ 22.0**	**$ 40.7**	**$ 28.9**
Net income per share	**$ 0.41**	**$ 0.34**	**$ 0.40**	**$ 0.37**
Adjustments to net income per share [3]	0.09	0.05	0.31	0.14
Adjusted net income per share	**$ 0.50**	**$ 0.39**	**$ 0.71**	**$ 0.51**
Net income	**$ 23.5**	**$ 19.8**	**$ 23.1**	**$ 21.5**
Stock-based compensation	1.8	2.2	10.3	8.0
Depreciation and amortization	1.0	1.0	4.0	4.1
Executive transition costs	0.4	—	5.4	—
Restructuring charges	2.5	—	2.5	—
Other income, net	(1.2)	(1.3)	(6.0)	(3.7)
Provision for income taxes	3.4	2.1	2.7	1.2
Adjusted EBITDA	**$ 31.3**	**$ 23.9**	**$ 42.0**	**$ 31.2**
Free cash flow				
Net cash provided by operating activities	$ 9.0	$ 13.8	$ 20.5	$ 26.1
Capital expenditures	(0.1)	(1.4)	(1.3)	(2.6)
Free cash flow	**$ 8.9**	**$ 12.4**	**$ 19.2**	**$ 23.5**

(1) Amounts may not total due to rounding.
(2) Amounts presented are net of tax.
(3) Refer to the sections “Use of Non-GAAP Financial Measures” for description of items included in adjustments.