Energy Recovery, Inc.
Form 10-Q
August 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
or
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to __________

Commission File Number: 001-34112

Energy Recovery, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**01-0616867**
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)
1717 Doolittle Drive, San Leandro, CA	**94577**
(Address of Principal Executive Offices)	(Zip Code)

(510) 483-7370

(Registrant's Telephone Number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2).

Yes No

As of August 1, 2016, there were 52,054,700 shares of the registrant's common stock outstanding.

ENERGY RECOVERY, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED JUNE 30, 2016

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

ENERGY RECOVERY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data and par value)

(unaudited)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$78,987	$99,931
Restricted cash	1,058	1,490
Short-term investments	15,095	257
Accounts receivable, net of allowance for doubtful accounts of $168 and $166 at June 30, 2016 and December 31, 2015, respectively	8,242	11,590
Unbilled receivables, current	1,804	1,879
Inventories	6,178	6,503
Deferred tax assets, net	—	938
Prepaid expenses and other current assets	1,272	943
Total current assets	112,636	123,531
Restricted cash, non-current	3,065	2,317
Unbilled receivables, non-current	—	6
Deferred tax assets, non-current	885	—
Property and equipment, net of accumulated depreciation of $19,872 and $18,338 at June 30, 2016 and December 31, 2015, respectively	9,762	10,622
Goodwill	12,790	12,790
Other intangible assets, net	2,216	2,531
Other assets, non-current	2	2
Total assets	$141,356	$151,799
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,518	$1,865
Accrued expenses and other current liabilities	5,233	7,808

Income taxes payable	89	2
Accrued warranty reserve	411	461
Deferred revenue	6,772	5,878
Current portion of long-term debt	10	10
Total current liabilities	14,033	16,024
Long-term debt, net of current portion	33	38
Deferred tax liabilities, non-current	2,109	2,360
Deferred revenue, non-current	66,462	69,000
Other non-current liabilities	637	718
Total liabilities	83,274	88,140
Commitments and Contingencies (Note 9)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 10,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, $0.001 par value; 200,000,000 shares authorized; 55,731,277 shares issued and 52,124,021 shares outstanding at June 30, 2016, and 54,948,235 shares issued and 52,468,779 shares outstanding at December 31, 2015	56	55
Additional paid-in capital	134,156	129,809
Accumulated other comprehensive loss	(101)	(64)
Treasury stock at cost, 3,607,256 and 2,479,456 shares repurchased at June 30, 2016 and December 31, 2015, respectively	(15,213)	(6,835)
Accumulated deficit	(60,816)	(59,306)
Total stockholders' equity	58,082	63,659
Total liabilities and stockholders' equity	$ 141,356	$ 151,799

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

ENERGY RECOVERY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended		**Six Months Ended**	
	June 30,		**June 30,**	
	2016	**2015**	**2016**	**2015**
Product revenue	$11,973	$10,484	$22,024	$16,348
Product cost of revenue	4,236	4,836	7,910	7,367
Product gross profit	7,737	5,648	14,114	8,981
License and development revenue	1,250	—	2,500	—
Operating expenses:				
General and administrative	3,992	5,362	8,876	11,640
Sales and marketing	1,935	1,994	4,005	4,427
Research and development	2,422	1,410	5,087	3,943
Amortization of intangible assets	158	158	315	317
Total operating expenses	8,507	8,924	18,283	20,327
Income (loss) from operations	480	(3,276)	(1,669)	(11,346)
Other expense:				
Interest expense	—	—	(1)	(40)
Other non-operating income (expense)	79	20	58	(82)
Income (loss) before income taxes	559	(3,256)	(1,612)	(11,468)
Provision (benefit) for income taxes	103	71	(102)	142
Net income (loss)	$456	$(3,327)	$(1,510)	$(11,610)
Net income (loss) per share - basic	$0.01	$(0.06)	$(0.03)	$(0.22)
Net income (loss) per share - diluted	$0.01	$(0.06)	$(0.03)	$(0.22)
Weighted average shares outstanding - basic	52,369	52,026	52,288	51,987
Weighted average shares outstanding - diluted	55,698	52,026	52,288	51,987

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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ENERGY RECOVERY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)

	Three Months Ended		**Six Months Ended**	
	June 30,		**June 30,**	
	2016	**2015**	**2016**	**2015**
Net income (loss)	$456	$(3,327)	$(1,510)	$(11,610)
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	6	(6)	(6)	25
Unrealized (loss) gain on investments	(32)	(2)	(31)	1
Other comprehensive (loss) income	(26)	(8)	(37)	26
Comprehensive income (loss)	$430	$(3,335)	$(1,547)	$(11,584)

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

ENERGY RECOVERY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended June 30,	
	2016	**2015**
Cash Flows From Operating Activities		
Net loss	$(1,510)	$(11,610)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	1,865	3,053
Depreciation and amortization	1,851	1,959
Provision for warranty claims	96	15
Unrealized loss on foreign currency transactions	52	21
Amortization of premiums on investments	34	130
Change in fair value of put options	33	—
Provision for doubtful accounts	16	59
Valuation adjustments for excess or obsolete inventory	(42)	21
Other non-cash adjustments	(49)	86
Reversal of accruals related to expired warranties	(146)	—
Deferred income taxes	(199)	131
Changes in operating assets and liabilities:		
Accounts receivable	3,333	3,472
Deferred revenue, product	855	714
Inventories	389	(1,520)
Income taxes payable	89	4
Unbilled receivables	81	60
Litigation settlement	—	(1,700)
Accounts payable	(347)	549
Prepaid and other assets	(384)	239
Deferred revenue, SLB license	(2,500)	—
Accrued expenses and other liabilities	(2,668)	(3,633)
Net cash provided by (used in) operating activities	849	(7,950)
Cash Flows From Investing Activities		
Maturities of marketable securities	—	8,235
Restricted cash	(315)	2,422
Capital expenditures	(613)	(429)
Purchases of marketable securities	(14,903)	—
Net cash (used in) provided by investing activities	(15,831)	10,228

Cash Flows From Financing Activities		
Net proceeds from issuance of common stock	2,511	293
Proceeds from long-term debt	—	55
Repayment of long-term debt	(5)	(2)
Repurchase of common stock	(8,378)	—
Net cash (used in) provided by financing activities	(5,872)	346
Effect of exchange rate differences on cash and cash equivalents	(90)	(18)
Net change in cash and cash equivalents	(20,944)	2,606
Cash and cash equivalents, beginning of period	99,931	15,501
Cash and cash equivalents, end of period	$78,987	$18,107

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

ENERGY RECOVERY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1 — The Company and Summary of Significant Accounting Policies

The Company

Energy Recovery, Inc. (the “Company”, “Energy Recovery”, “Our”, “Us”, and “We”) is an energy solutions provider to industrial fluid flow markets worldwide. We make industrial processes more operating and capital expenditure efficient. Our solutions convert wasted pressure energy into a reusable asset and preserve or eliminate pumping technology in hostile processing environments. Our solutions are marketed and sold in fluid flow markets, such as water, oil & gas, and chemical processing, under the trademarks ERI®, PX®, Pressure Exchanger®, PX Pressure Exchanger®, AT™, AquaBold™, VorTeq™, IsoBoost®, and IsoGen®. Our solutions are developed in whole or in part, in the United States of America (“U.S.”), as well as other locations internationally.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles (“U.S. GAAP”) requires our management to make judgments, assumptions, and estimates that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. The accounting policies that reflect our more significant estimates and judgments and that we believe are the most critical to aid in fully understanding and evaluating our reported financial results are revenue recognition; allowance for doubtful accounts; allowance for product warranty; valuation of stock options; valuation and impairment of goodwill, long-lived assets, and acquired intangible assets; useful lives for depreciation and amortization; valuation adjustments for excess and obsolete inventory; and deferred taxes and valuation allowances on deferred tax assets. Actual results could differ materially from those estimates.

Basis of Presentation

The condensed consolidated financial statements include the accounts of Energy Recovery, Inc. and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

The accompanying condensed consolidated financial statements have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The December 31, 2015 condensed consolidated balance sheet was derived from audited financial statements, and may not include all disclosures required by U.S. GAAP; however, we believe that the disclosures are adequate to make the information presented not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto for the fiscal year ended December 31, 2015 included in our Annual Report on Form 10-K filed with the SEC on March 3, 2016.

In the opinion of management, all adjustments, consisting of only normal recurring adjustments that are necessary to present fairly the financial position, results of operations, and cash flows for the interim periods, have been made. The results of operations for the interim periods are not necessarily indicative of the operating results for the full fiscal year or any future periods.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers.* The amendment requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. On July 9, 2015, the FASB voted to approve a one-year deferral of the effective date of ASU 2014-09. Based on the FASB’s decision, ASU 2014-09 will apply to us for annual reporting periods beginning after December 15, 2017, including interim reporting periods within annual reporting periods beginning after December 15, 2017. Additionally, the FASB decided to permit early adoption, but not before the original effective date (that is, annual periods beginning after December 15, 2016). The FASB issued ASU 2015-14 in August 2015, formally deferring the effective date of ASU 2014-09 by one year. We expect to adopt this guidance as of January 1, 2018. ASU 2014-09 permits the use of either the retrospective or cumulative effect transition method. We are currently evaluating the effect that ASU 2014-09 will have on our financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes (Topic 740) - Balance Sheet Classification of Deferred Taxes*. ASU 2015-17 eliminates the current requirement to present deferred tax assets and liabilities as current and noncurrent in a classified statement of financial position. Instead, ASU 2015-17 requires that deferred tax assets and liabilities be classified as noncurrent in a classified statement of financial position. We early adopted this accounting standard update, on a prospective basis, at the beginning of the second quarter of 2016 to simplify presentation of deferred taxes. The adoption at the beginning of the second quarter resulted in a $1.1 million decrease in current deferred tax assets, a $0.8 million increase in non-current deferred tax assets, and a $0.3 million decrease in non-current deferred tax liabilities. No prior periods were retrospectively adjusted.

In January 2016, the FASB issued ASU No. 2016-01 *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 modifies certain aspects of the recognition, measurement, presentation, and disclosure of financial instruments. For public entities, ASU 2016-01 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, and early adoption is permitted. We do not expect the adoption of this standard to have a material impact on our financial statements.

In February 2016, the FASB issued ASU No. 2016-02 *Leases (Topic 842).* ASU 2016-02 impacts any entity that enters into a lease with some specified scope exceptions. The guidance updates and supersedes Topic 840, Leases. For public entities, ASU 2016-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. We are currently evaluating the impact of this guidance on our ongoing financial reporting.

In March and April 2016, the FASB issued ASU No. 2016-08 and ASU No. 2016-10, respectively, *Revenue from Contracts with Customers (Topic 606).* The amendments in the Updates are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations and to clarify two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance, while retaining the related principles for those areas. The effective date and transition requirements for both ASU 2016-08 and ASU 2016-10 are the same as those for ASU 2014-09 as deferred by ASU 2015-14.

In March 2016, the FASB issued ASU No. 2016-09 *Compensation – Stock Compensation (Topic 718).* ASU 2016-09 affects any entity that issues stock-based payment awards to their employees and is intended to simplify several aspects of the accounting for stock-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For public entities, ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods with those annual periods. Early adoption is permitted. We have not evaluated the impact of this guidance, but do not expect the adoption of this standard to have a material impact on our financial statements.

Note 2 — Goodwill and Other Intangible Assets

Goodwill as of June 30, 2016 and December 31, 2015 of $12.8 million was the result of our acquisition of Pump Engineering, LLC in December 2009. During the three and six months ended June 30, 2016, there were no changes in the recognized amount of goodwill, and there has been no impairment of goodwill to date.

The components of identifiable other intangible assets, all of which are finite-lived, as of the dates indicated were as follows (in thousands):

	June 30, 2016			
	Gross Carrying Amount	**Accumulated Amortization**	**Accumulated Impairment Losses**	**Net Carrying Amount**
Developed technology	$6,100	$ (4,016)	$ —	$ 2,084
Non-compete agreements	1,310	(1,310)	—	—
Backlog	1,300	(1,300)	—	—
Trademarks	1,200	(180)	(1,020)	—
Customer relationships	990	(990)	—	—
Patents	585	(411)	(42)	132
Total	$11,485	$ (8,207)	$ (1,062)	$ 2,216

	December 31, 2015			
	Gross Carrying Amount	Accumulated Amortization	Accumulated Impairment Losses	Net Carrying Amount
Developed technology	$6,100	$ (3,711)	$ —	$ 2,389
Non-compete agreements	1,310	(1,310)	—	—
Backlog	1,300	(1,300)	—	—
Trademarks	1,200	(180)	(1,020)	