Drexel Hamilton Analyst: Thank you all for coming to Drexel Hamilton's Emerging Growth Conference 2016. I am proud to introduce Graham Corporation. Joining us from Batavia, New York, we have the CEO, Jim Lines; and CFO, Jeff Glajch. They will be giving a presentation, but before that, a little bit about Drexel Hamilton. Just quickly, we are the largest, better-known broker/dealer on the Street. We make it our mission not only to employ veterans of Wall Street, but we also have an eye on giving an offering to other veterans. So, with that let me offer Jim to you and good luck.

Jim Lines: Thank you, Kevin. Good morning. Graham is an 80-year-old company. We are an industrial company that engineers, fabricates, and sells custom fabricated equipment to energy markets in the defense industry and the power generating market. Our financial goals are to grow our business organically via taking market share. Currently, we are running our businesses at about $90 million of annual revenue.

Our goals are to run our operations profitably, of course, with an EBITDA margin in the mid-teens. We're in a bit of a down cycle in the energy sector. Our EBITDA margin last year was 12.1%, when over a decade prior that averaged in the mid-teens. And of course, capital stewardship has a fair amount of importance for us. We have a fair amount of capital on our balance sheet that we wish to deploy. Our current ROIC is just under 6% and our goal is to drive ROIC to greater than 12%.

Regarding our strategies for growth, we have some very distinctive differentiators compared with our competition. We have a unique selling model. We have tremendous engineering capabilities in the areas of heat transfer, fluid flow, vacuum technology, and mechanical design. We are very skilled at fabricating very large weldments to exacting quality standards of exacting dimensional tolerances for the refining, petrochemical, power generating and U.S. naval markets.

In the short-term, our goals are to drive revenue through share growth. Our next step in our business growth is to reach the $200 million revenue level, principally through organic growth and the execution of our strategies.

Long-term, we plan to continue deploying our capital, diversifying the revenue streams and strengthening our earnings through deployment of capital in M&A. We have been focused on diversifying. If you've followed Graham over the last couple of decades, going back about five years ago and earlier, we had a high concentration of sales in refining and petro-chemicals; about 70% to 80% of our sales were in oil refining and petrochemical industries. Over the last five or six years, we've focused intently on diversifying our revenue, entering into the naval nuclear propulsion program and also into the commercial nuclear market.

Today, our revenue by market mix is still concentrated at about two-thirds in the classic refining and petro-chemicals, power is about 20% and our naval revenue segment is about 10% of sales currently. Ultimately, as we execute our diversification strategies, we're driving toward a more well-balanced market mix of anywhere between 15% to 30%, depending upon the market. That will have the very important aspect of reducing earnings volatility due to the concentration we had in chemicals and refining.

Refining represents about $150 million to $200 million of annual opportunity. We have about a 25% global market share for the products that we provide to that industry. Here we have share growth strategies and are being aggressive, because we have a very strong brand, we are very well recognized, and we are often preferred. So we employ strong customer facing strategies and crisis management strategies.

For the petrochemical industries, there, too, the opportunity is in the area of $150 million to $200 million per year for our products. We have a lower share, globally at about 15%. Here, too, we are intent on taking global market share though our ability to expand our execution capacity and to access more opportunities with our customer-facing organization, getting closer to our customers in the emerging economies.

In the U.S. Navy, we have a pretty narrow focus with our product offering. That annual opportunity is about $50 million. Looking back, we've had about a 10% market share. We are seeing our market share improve and becoming far stronger than the 10% market share.

And in the power market, the principal markets that we are focused on here are the nuclear power generating market and renewable energy, including geothermal. Here our share position is under 10%; there is a lot of runway for growth in that particular market.

You heard me mention a moment ago about growing from where we are today, $90 million, to the next plateau, wanting to achieve $200 million revenue, and here is the pathway of how we will do that. As we step through our key end-markets, part of the growth is a recovery from the current contraction in the chemical and refining industries. Those have fallen off about 20% to 25% from where they had been two years or three years ago. That should not be a surprise to anyone who is following the energy sector. Thereafter, with share growth, it's about taking additional market share from our competitors as we build execution capacity in our engineering area and in our fabrication area.

And then, in the naval segment, it is about driving our strategy. We have a very strong portion of our backlog that's for that particular end-market and we have a very strong view of that; we have lateralized that strategy as a vision. And then, in the nuclear power market, that segment is growing by about $15 million to $25 million, to reach our $200 million revenue goal.

Stepping through those pieces by market, it gives us revenue growth of $110 million, of which about $40 million is market recovery, and the other $70 million is execution of our strategies and share growth.

Another important aspect of our management strategy has been to reduce earnings volatility. Here, we are driving the more predictable segments of our business that don't have the variation of our large capital sales. About 10 years ago, that was at about $20 million per year. Last year, it was just over $50 million. And in there, that's our nuclear market, maintenance, repair, refurbishment business, our naval strategy and our short cycle business that typically comes in and out in about in one quarter, whereas our large capital sales may be awarded then shipped in 12 months, 15 months or 18 months. So, we're driving this more predictable, less volatile portion of our business, and the team has done a very nice job moving that from about $20 million to over $50 million last year.

We have a fantastic backlog. Our backlog is $104 million as of the end of September. What is important to point out is, a bit over 60% of that backlog is from markets that Graham had not served six or seven years ago. It is backlog associated with our U.S. naval work and with our power markets. Another distinction of our backlog that I like to point out is, in our past, generally 80% to 90% of our backlog converted in 12 months. Because of the nature of our backlog currently, we now have more long-lived backlog. Only about half of the backlog converts in 12 months, which gives us stronger visibility in out years and, as a management team, gives us better understanding of where our business is going to be not just two quarters out, but two years out.

This chart on slide 11 is more illustrative of the impact of our diversification strategies. The dark blue bars are our core Graham, seven years ago and prior to that. You can see that, in fiscal 2009 and earlier, all we had was refining and petrochemicals as our market sales for all intents and purposes. And then, with our diversification efforts, the lighter blue bars represented about 60% of our backlog at the end of fiscal 2016, which is from markets that we weren't serving prior to fiscal 2009.

So, our team has done a really solid job in executing in this area, which has been very impactful, particularly with this downturn in the energy sector which has been the worst in my 30 plus years with the Company. This has been a very tough downturn. And so, we are very thankful for the execution of our diversification strategies.

One of the great aspects about Graham is, we're involved in bidding activity very early, and we have a very rich pipeline of opportunities and of prospects that we're pursuing. It totals about $600 million to $800 million on a trailing 12-month basis. This includes bids of a wide variety including concept, budget, and multiple EPC bids. But that's always been a very good barometer of the direction of our business in terms of an absolute magnitude and also the quality of the bids in our pipeline. So we are very pleased by the way our team has built up our pipeline. Ten years ago, that was about $300 million or $400 million pipeline. Today, it's about twice that.

What we do, what we look for, and what we're known for is providing equipment that is critical to our customers' process or vessel if it's a naval sale. Failure and subpar performance is disastrous for the user. They have no tolerance for performance failure, either contractually, from a quality point of view, for on time delivery, or of course the operation of the equipment once installed. Also the equipment is very complex and almost impossible to replace in most cases. What that typically drives is a purchase decision that's based more on value than on price. So we tend to focus where our customers will have price in the equation of who they are going to select, but it's not the top decision criteria. There are other factors that they'll look at - experience, reliability, proven know-how – and then, price is in the equation somewhere in the top three or five. So, we're not winning orders on price; that's not what we do well. We actually win on differentiation, and that shows up in our margins.

So with our customer-facing platform, we're in the sales channel for a long period of time before something is bought. Ideally, we're chasing an opportunity for one, two, or three years before they place an order. That gives us immense intelligence and that gives us immense contact time with the decision makers. We built our front end of the business to be able to do that effectively. Many of our competitors tend to enter into sales cycles about the time something is going to be bought; whereas, we've spent quarters, if not years, investing time in understanding what's important. And that tends to show up in our margin and our success rate. We have a very high capture rate and also we feel we have, through our differentiation, high margins when we do win this work.

On slide 16, this gives an illustration of the way we've been able to operate our business. And yet, for anyone who has followed Graham for more than a decade, that 12% EBITDA margin for last year used to be our peak EBITDA margin in prior years. That's now our trough EBITDA margin, resulting from how the management team has focused on productivity, quality, lead time reduction and leveraging our infrastructure.

We believe our decade average EBITDA margin is in the mid-to-upper teens, where our peak margins could be as high as 20% to 25%, and our trough margin is in the range of about 12%. That has been a transformation of our business. Again, if you compare this past decade to Graham's prior several decades, there's a far different level of financial performance that the team has been able to generate.

We have a tremendous balance sheet, with $66 million in cash, almost $7 a share, and we carry no debt. We have very strong operating cash flow, which contributes, of course, to the cash that we have on our balance sheet. We're focused on working capital utilization. When the management team took over seven to ten years ago, our working capital was in the range of 15% to 20% of sales and today it's more in the range of 5% to 10% of sales. It can vary a bit based on the timing of receivables but, on average, we've been able to shift that down quite appreciably.

With our capital expenditures, we tend to think about it over a longer period of time as balancing out with depreciation and amortization, which is about $2 million to $2.5 million annually. We made a fairly large capital investment in fiscal 2014 and 2015 to expand our capacity. We pulled back in fiscal 2016 and further in fiscal 2017, simply because we wanted to digest the investments that we made, make sure the team is leveraging those investments and maximizing those investments' capabilities.

We mentioned our cash generation. This gives an illustration since the period when the current management team took over. At the end of fiscal of 2005, our cash position was about $1 million. Over the next decade or so, we generated about $113 million of net income, and we've returned about $27.5 million to shareholders. We did so with share repurchases and with dividends. We invested capital into our facilities of about $25 million, and we made an acquisition of about $20 million. Our cash position is now sitting at $66 million, a very strong cash generator typically throughout the cycle, but particularly in the up cycle; great cash generation, more than the business needs.

Regarding our priorities for capital allocation, our focus for our operating cash flow is to reinvest for organic growth. We invest back into our business and we also pay dividends. We have about 1.5% dividend yield today, and our dividend is $0.36 a share.

The focus for our balance sheet capital is on acquisition, diversifying the revenues, and also for stock repurchases when it is appropriate to do so. In the last 18 months or so, we've bought back about $9 million worth of stock. We have had a keen focus on our shareholders. We aggressively increased our dividend over successive years from what had been $0.08 per share for a period of time to $0.36 per share today. We've also been out marketing our Company to institutions. We feel we have a great story to tell. The institutional ownership about a decade ago was about 36%. Today, approximately 75% of our shares are held by institutions.

With our balance sheet capital, we have an acquisition program in place, and it's very active. We are looking for businesses that complement what we do extraordinarily well. We want to stick to our knitting, which would be a product that's engineered-to-order, has customized fabrication, and a strong management team that wishes to stay with the business. The revenue range, which is typically the sweet spot, not the transaction range, would be between $20 million and $60 million.

And we are not simply looking for an accretive acquisition. We are looking for a business that provides an equity-based return on capital invested. That causes us to be extremely discerning about the qualities of the business. In our evaluation of the business, we are disciplined. We've walked away from a number of opportunities in the last year or so, just because the valuation wasn't right. It would have very well been accretive, but it wasn't good capital stewardship.

Our current fiscal year 2017 will end on March 31, 2017. Our guidance for fiscal year 2017 that was given in early November is for revenue to be between $85 million and $95 million, gross margin in the 21% to 23% range, SG&A of $15 million to $15.5 million and our effective tax rate is projected to be between 30% and 31%.

Regarding our investment highlights, while the energy sector has had a cyclical downturn, we believe that the energy sector long-term will recover. There will be capital investment, new capacity, and investment in existing asset bases to improve their operating performance. We are very bullish long-term, recognizing there are some challenges short-term. I mean, we really believe long-term in the energy space. We have a leading position in the products that we offer, whether they're to the U.S. Navy, the global refining sector or the global petrochemical sector. We have a premium brand. We sell a differentiated solution, and we are rewarded for that differentiation, we feel, most often and as reflective of our margins.

We have a terrific balance sheet as we said. We have an acquisition program in place that is led by Jeff. We brought in a new business development director about six months ago, who is working with Jeff. So that program has a lot of traction, a lot of activity.

We have a management team that is like-minded and long-term focused and a board that's aligned with management on value creation. We're in a very compelling investment place to consider Graham. We have top quartile financial performance, whether it be the gross margin line or EBITDA margin line, and again, strong cash generation throughout the cycle.

With that, Jeff and I would be very happy to answer whatever questions you might have.

Question: *[Inaudible]*

Jim Lines: Yes. Sure. Actually, when Graham was founded in 1936 by Harold Graham, he had developed the heat exchanger, which is a coiled heat exchanger and its trademark name was Heliflow. It's a particular type of heat exchanger that's very compact, suitable for high pressures. It's a particular, very specialized heat exchanger; it was a very niche heat exchanger. At one point, Graham was called the Heliflow Corporation.

Question: *[Inaudible]*

Jim Lines: There was no specific reason unique to Graham. The energy space all lifted up the day after the election and over the ensuing three weeks or so, depending upon the company, it jumped up 10% to 25% with the enthusiastic post election.

Question: *And the final thing is, what specifically can you do for the Navy again? And what's the projection on growth with the Navy?*

Jim Lines: For the U.S. Navy, we provide heat transfer equipment that supports the propulsion systems for aircraft carriers and submarines. There are two submarine programs and one aircraft carrier program, and we are in all three of those programs. We are very critical to the power put into the submarine and it's a very large, specialized heat exchanger, typically, that we provide. I can't say too much about it, but we run silent, run deep and run well.

Question: *[Inaudible]*

Jim Lines: The question was, what was the catalyst for the fantastic performance of fiscal 2015? 2015 was when the revenue began to come through for the orders that we booked in mid calendar 2013, which were associated with the North American petrochemical expansion cycle that was driven off of low cost natural gas associated with shale. There had been a decade of under investment in North American petrochemical complexes, and when the Atlantic shale gas and those technologies brought the cost of gas down, there was an immense amount of investment in new capacity in North America. We benefitted from that. That came in a very big wave, and we think there will be a second wave that will come, but that was the result of the first wave.

Question: *So, you mean during 2018 then there will be the next wave? Where do you anticipate it?*

Jim Lines: The bookings could come in fiscal 2018, but we expect the next wave in revenue to lead across fiscal 2019 and fiscal 2020, and it may not be as large as that first wave of business.

Question: *And until then, it looks like your earnings will be pretty much flat?*

Jim Lines: No. We feel there will be traction with our navel strategy, which is going to step up. Our backlog for our naval program is at $60 million and we are at a point now where that's beginning to convert to revenue, so there will be a step up in our naval revenue. We are not expecting flattish revenue. We are expecting some growth, not like the growth from 2014 to 2015, though, absence of an acquisition.

Are there any other questions that Jeff or I could answer for you? Okay. Thank you so much for your time and thank you for your questions.

Drexel Hamilton Analyst: Jim, Jeff, thank you very much for your time. I appreciate it.

Jeff Glajch: Thank you.

Jim Lines: Thank you.