

Operator: Greetings and welcome to Graham Corporation's Fourth Quarter and Full Fiscal Year 2018 Financial Results. At this time, all participants are in a listen-only mode, a question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to Karen Howard, Investor Relations for Graham Corporation.

Karen Howard: Thank you, Cheri, and good morning, everyone. We appreciate you joining us today to discuss the results of Graham's fiscal 2018 fourth quarter and full year results. You should have a copy of the news release that was distributed across the wires this morning. We also have slides associated with the commentary that we're providing here today. If you don't have the release or the slides, you can find them on the company's website at www.graham-mfg.com.

On the call with me today are Jim Lines, our President and Chief Executive Officer; and Jeff Glajch, our Chief Financial Officer. Jim and Jeff will review the results for the quarter and fiscal year, as well as our outlook. We will then open the lines for Q&A.

As you are aware, we may make some forward-looking statements during this discussion, as well as during the Q&A. These statements apply to future events and are subject to risks and uncertainties, as well as other factors, which could cause actual results to differ materially from what is stated on the call. These risks and uncertainties and other factors are provided in the earnings release and in the slide deck, as well as with other documents filed by the company with the Securities and Exchange Commission. Those documents can be found on our website or at www.sec.gov.

I also want to point out that during today's call, we will discuss some non-GAAP financial measures, which we believe are useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results prepared in accordance with GAAP. We have provided reconciliations of comparable GAAP to non-GAAP measures in the tables accompanying today's earnings release.

And with that, it is my pleasure to turn the call over to Jim to begin. Jim?

Jim Lines: Thank you, Karen. Good morning, everyone. We appreciate your participation in our fourth quarter conference call. I will begin my prepared remarks referring to slide 3. We had another strong quarter with new orders that totaled \$43.5 million. This is similar to the level of orders in our third quarter. In striking contrast to the deepest period of the cyclical downturn in our refining markets, orders in the last two quarters totaled more than \$80 million while, by comparison, during the four quarters from the third quarter of fiscal 2017 through the second quarter of fiscal 2018, orders totaled \$55 million. Worth noting, the bookings for the last two quarters were approximately \$50 million removing two large orders that we don't believe occur every quarter.

Revenue has started to turn upward compared with the previous two quarters. Revenue in the quarter was \$22.2 million. Income also showed corresponding improvement with \$0.09 earnings per share in the quarter.

Full year highlights include a record \$117.9 million backlog at year-end. Full year bookings were \$112.2 million, including a nice surge in orders from our refining markets. Crude oil refining market orders were 39% of total orders. Also, there was a strong level of orders for our naval end markets that were approximately 25% of total orders for the year. \$77.5 million of full year revenue reflected the consequence of the \$55 million in orders for the 12-month period I mentioned a moment ago.

We reported a \$9.8 million loss for the year which was impacted by impairment and related charges tied to writing down Energy Steel assets along with, and to a lesser extent, restructuring charges. On an adjusted basis, net income for the full year was \$1.8 million.

Please move on to slide 4. Sales in the fourth quarter of \$22.2 million, were down compared to a year earlier. However, there is sequential improvement compared to the December ending quarter that was \$17.3 million and the second quarter that was \$17.2 million.

Sales to our refining markets were up, while sales to our other end markets were down in the quarter versus a year earlier. I believe fiscal 2018 represents the bottom of the downturn and that revenues will expand in fiscal 2019. There was no escaping the impact of the dismal order level that was anemic across the third quarter of fiscal 2017 through the second quarter of fiscal 2018. Full year revenue was down approximately 18% relative to fiscal 2017 and totaled \$77.5 million. 66% of sales were to domestic end markets.

I will let Jeff provide more financial details on the quarter and the full year. Jeff?

Jeff Glajch: Thank you, Jim, and good morning everyone. On to slide 6 please. As Jim mentioned, the last three quarters of the fiscal year have been pretty rough and appear to be the bottom of the downturn, and the financial results are reflective of this. Sales in the fourth quarter were \$22.2 million, down from \$25.6 million in last year's fourth quarter. The split of sales was 66% domestic and 34% international compared with last year's fourth quarter which was 78% domestic and 22% international. Gross margins in the quarter were 22.8%, down from 26.3%. Adjusted EBITDA margin was 6% for Q4, down from 12% last year.

Reported Q4 net income and EPS was \$800,000 and \$0.09 per share, compared with \$1.8 million and \$0.18 per share. However, we had a favorable tax adjustment related to the new tax law. Adjusting for that resulted in earnings of \$600,000 and \$0.07 per share in the fourth quarter this year.

On to slide 7 to look at the full year results. Sales declined to \$77.5 million, down from \$91.8 million last year. As Jim mentioned, we worked through a low bookings level which occurred 12 to 18 months ago. Sales for the year were 67% domestic, 33% international compared with last year which was 75% domestic and 25% international.

Gross profit for the year was \$17.3 million, down from \$22.2 million primarily due to lower volume as well as the impact of gross margins being 170 basis points lower at 22.4%. SG&A for the year was \$15.6 million, up from \$14.9 million last year. However, last year's number included a \$750,000 insurance settlement. When you adjust for that, SG&A was flat year-over-year. EBITDA margin was 5.4%, down from 10.5% last year, and adjusted net income was \$0.18, compared with \$0.56 last year.

EBITDA and net income were both adjusted to exclude the impact of the write-down for the impairment of our nuclear business and related charges that were booked in Q3, as well as restructuring charges, offset partially by the favorability of onetime impacts from the implementation of the new tax law.

On to slide 8 please. You see our cash position increased by \$3 million in fiscal 2018 to \$76.5 million, or \$7.83 per share. We had good cash flow from operations, paid \$3.5 million in dividends and spent \$2.1 million in capital investments this year, well above the \$300,000 level of capital spending in fiscal 2017. We expect capital spending in fiscal 2019 to be between \$2 million and \$2.5 million.

Our acquisition pipeline continues to be strong. Identifying the correct company to purchase requires diligence and discipline. We were well into a diligence process over the past two quarters for a company whose management team we liked. However, we ultimately decided the predictability of their business and its market position were too volatile for us to meet the purchase price expectations. Therefore, we peeled off this opportunity in the fourth quarter.

However, our business development team, our management team and our board of directors are all focused on utilizing the cash and our strong balance sheet to opportunistically identify and close on

acquisitions which have both near and long-term benefits to our shareholders. We will continue this effort into fiscal 2019.

With that, Jim will complete our presentation and comment on our strong outlook for fiscal 2019.

Jim Lines: Thank you, Jeff. I now refer to slide 10. The uptick in orders over the past two quarters provides a terrific foundation for fiscal 2019. We remained actively bidding a broad array of projects in all of our markets, and that continues today. Our refining customers released, in the third and fourth quarters, purchase orders for a number of revamps and upgrades to existing facilities. That is what drove the uptick in orders, as did orders from our naval markets.

Note that orders in the fourth quarter were up compared to a year earlier in each of the four key end markets. Orders from the refining market were up \$10 million and for our naval end markets, they were up measurably as well.

On to slide 11. I am extremely pleased by our backlog, which is at a record \$117.9 million. The quality of our backlog has improved due to price levels and end market mix for recent orders. You may recall in the past we noted that refining markets provide the highest margins for new equipment revenue. Thus, the uptick in refining orders is a positive.

Also, we have worked through most of the rough orders in backlog taken at the cycle bottom because that was all that was available and we concentrated on loading our operations. Therefore, margin quality backlog on average is improving due to the recent orders.

Lastly, our large naval backlog is entering its revenue cycle that extends for two to three years in certain cases which, of course, lowers our asset base and increases utilization levels. Importantly, 55% to 60% of the March 31 backlog is planned or projected for shipment across fiscal 2019.

Moving on to introduce our guidance for fiscal 2019 on slide 12. Initial full year guidance has the top line between \$90 million and \$95 million. Gross margin will range between 24% and 25%. SG&A will be in the range of \$18 million to \$18.75 million. Our effective tax rate will be between 20% and 22%. There is upside potential to the top line tied to timing and success in securing various orders from our quotation pipeline. There is some downside risk as well. However, we are optimistic about driving the top line higher.

Cheri, please open the line for questions. Thank you.

Operator: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question is from Joe Mondillo with Sidoti & Co. Please proceed.

Joe Mondillo: Hi, guys. Good morning.

Jim Lines: Good morning, Joe.

Jeff Glajch: Good morning, Joe.

Joe Mondillo: So my first question is on the SG&A, a little higher than I was anticipating. Is that all related to selling expenses, commissions, based on the oil refining backlog that you have that's going to hit in 2019, or is there any compensation that was abnormally low over the last year or two? Just wondering if you could comment on that.

Jeff Glajch: Joe, this is Jeff. All of the above. Certainly, there's the impact of the low level of compensation in fiscal 2018. There's the impact of some additional hiring, some resources we're bringing on board. For example, we hired a new Vice President of Sales in late February and we'll have the full

year impact of him being on board. Also, we're looking at adding some key resources to our team as we look forward, not just into fiscal 2019, but beyond to make sure that we're able to take advantage of the opportunities we think are in front of us in our commercial market.

So, as you know, we've been pretty tight on SG&A in the last couple of years and particularly in fiscal 2017 and 2018, as we worked our way through the downturn. We're just adding the resources we need to add. Obviously, the comp, as you mentioned, and there will be some additional commission activities around some of our refining. So it's really all of the above.

Jim talked about our revenue guidance and SG&A ranges. If we're at the lower end of the revenue range, we're likely to be at the lower end for SG&A, and the middle or higher end of the SG&A range is more likely to occur if we're at the upper end of the revenue range. As Jim mentioned, perhaps we'll be fortunate enough to push beyond that.

Joe Mondillo: Okay. Could you talk about the changes that have been made over the last several years? I'm going back to the peak of fiscal 2015. You saw \$135 million of revenue and \$18.5 million of SG&A. So I'm now looking at \$90 million to \$95 million of revenue and pretty much at that peak SG&A, could you just talk about what changes have been made over the years that are causing peak SG&A when we're not back to peak revenue yet?

Jeff Glajch: Sure. So, part of it again is adding some resources to look toward the future. Clearly, there's some inflationary issues that can't really be offset. One of the areas that we've not been impacted by is rising healthcare costs. We've been able to keep those under control. So, again, it's really adding to our team, looking toward the future and making sure we have a team, not just for fiscal 2019, but for growth beyond that.

If we believe that fiscal 2019 is a step-up and nothing beyond that, we might temper some of our additions. But, we believe there's a good chance for growth opportunities beyond 2019. So, again, we don't have those locked down yet.

Joe Mondillo: Okay. And then I wanted to ask about the revenue guidance. It looks like almost 75% of your revenue guidance is already in your 12-month backlog. So, you have a very healthy 12-month backlog going into the year. Just wondering if you could talk about the short cycle part of the business, if you could quantify how much that made up in fiscal 2018 and how that's trending. And could the guide on revenue be a little light just given what you do have in your 12-month backlog?

Jim Lines: Hi, Joe. This is Jim. Let me talk about this in a little detail from the perspective of what's tugging at management that led us to put the guidance where we put it.

We see some risk in our naval backlog execution, not tied to us, but tied to our ability to get it into the revenue cycle as it relates to designs being frozen and getting releases from our customers to proceed with fabrication. That's a fairly sizeable risk. We feel very confident that we're going to drive through that and get that revenue converted. However, we do see some risks there and they're fairly measurable. As a result, we've come in with guidance that, as you suggested, the backlog would infer 75% set up which is at the higher end of what our historical range would be. We typically think in terms of backlog entering the year representing approximately 60% of revenue for the full year, although at cycle bottoms it has been as high as 70%. So we're just a little bit cautious on some of the first-generation design work for the Navy that's in our backlog. Whether we float into the revenue cycle as we've modeled, we've been a little cautious with respect to that.

On our short cycle work, compared to the 2015 timeframe that you cited around SG&A, we're off about 20% from that level, but we're up about 10% from when it bottomed. We are seeing some improvement there, but it's still down. I am not seeing at this point in our quotation activity or selling activity where it's implying to us that it's returning back toward the 2015 level during fiscal 2019.

Around the SG&A adds, as Jeff said, we are taking a more bullish look at multiyear expansion cycles that we feel rather confident about, but we're going to meter in the additional hires and the expansion of our workforce according to how we see the pipeline translate into orders. We put forward a more bullish outlook for SG&A spend. However, as Jeff had indicated in his remarks, we're going to be mindful of how quickly we add those expenses.

This gives you the range on the upper end that supports our bullish multiyear outlook. If that's not playing out as we envision, we'll adjust accordingly. So really around the guidance which is the biggest question that you had, we have some concern about naval backlog conversion not tied to our ability to execute it but tied to our ability to get it to the revenue cycle, after we are released by the shipyards, and the designs are frozen. We have no control over that. As a consequence, we've been more measured. Also with that in mind, we still need about \$10 million to \$12 million of large project work that's not in our backlog to fill out the year.

Pipeline seems fine, but we've been chasing these bids for several quarters. Our customers keep pushing some of these to the right. We have some very strong optimism we'll be in a better position after the first quarter closes to have a clearer view of where the naval work is and what we've been able to close in the quarter to begin to fill out the rest of our year. In my closing prepared remarks, I mentioned that we are optimistic about driving the top line higher. I just wanted to share with you what's tugging at us and what caused us to put the guidance where we put it initially.

Joe Mondillo: Okay. That's helpful. So just to clarify on that though, the \$67 million comes out to be roughly 12 months of backlog, if you do the math. Is that including some of this questionable backlog?

Jim Lines: Yes.

Joe Mondillo: So some of that could be pushed out beyond 12 months?

Jim Lines: Right. If we took the midpoint of the 55% to 60%, it basically represents \$68 million planned for fiscal 2019 of the total \$118 million. Of that, somewhere between 5% and 10% is at risk, as I cited, related to our ability to get naval work into the revenue cycle. We have to bear in mind that if it goes well, we're going to plow right through the guidance range. If it doesn't flow as we expect, we have to make it up with new orders and the timing of those new orders could affect us. But that's a quarter-to-quarter effect, not an indication of the cycle recovering.

Joe Mondillo: Okay. That's good color, Jim. Thanks. In terms of the short cycle work, what does that generally, on an absolute revenue basis, quantify to annually?

Jim Lines: Maybe you've heard us say over the years, we're one-third short cycle, two-thirds project work. In terms of absolute dollars, we tend to think in the range of \$25 million to \$30 million for that short cycle work on an annual basis.

Joe Mondillo: Okay. And you said that's off 10% from the bottom, so it's growing maybe around 10% annually right now?

Jim Lines: We're off about 20% from the 2015 peak. We're up 10% from the trough. 2018 was comparable to 2017.

Joe Mondillo: Okay. Okay. That's good color. And then the 12-month backlog, or the near-term backlog, how does the gross margin of that backlog compare to the 24% to 25% that you guided to for the year? Is it pretty comparable?

Jim Lines: Yes. Without getting too granular, but more on a qualitative basis, what we have stated in our prepared remarks, is that what's coming into backlog is superior to what was coming out of backlog. That's averaging up our overall margin in backlog, which is great, and that's reflective of a little bit of a move upward in our overall gross margin. If we push through the top line guidance and we lowered our asset base a little more, we'll see that gross margin inch up.

Joe Mondillo: Are any of these big oil refining projects super high gross margin? So if you don't see another one of those orders, fiscal 2020 potentially could see a tough comp? Just wondering if there's anything really boosting the gross margin this year, just want to be cognizant of that.

Jim Lines: Joe, there's nothing as an outlier that represents why the gross margin is where it is. The large project we spent some time talking about in the third quarter has a very high material content which has an effect on some of our margin profile. But I'm not judging that 2019 is an outlier on the upside relative to where we expect 2020 to go.

Joe Mondillo: Okay. And then just in terms of the Navy backlog over the next couple of years. Say, this backlog that's potentially at risk does end up falling into fiscal 2019, just wondering about expectations for fiscal 2020. I know that big order in terms of the submarine backlog from 2015 I think it hit, it's finally starting to be shipped. And I think fiscal 2020 was supposed to be a much stronger year than even fiscal 2019. So I'm just wondering if everything hits in terms of timing right now, what does 2020 look like relative to 2019? And I think 2019, you mentioned on the last call, was going to be potentially flat to up 40% or so. If you could give us a little color on how to think about that part of the revenue for the next couple of years.

Jim Lines: Sure, Joe. The comment that I made around 2019 and the risk of naval backlog conversion, I would suggest that's a quarter to a couple quarters risk. The backlog is not at risk in a broad sense. It's just a timing risk. From our modeling of how we see the backlog for the naval strategy rolling out, we're into the peak revenue cycle in 2019, 2020 and 2021. We're expecting it to move beyond the \$20-ish million level as we're in 2020 and 2021, that's the revenue cycle now. What I cited about risk was a one- or two-quarter potential delay in getting that work into the revenue cycle.

Jeff Glajch: Joe, this is Jeff. Just to add one additional point here. As Jim just mentioned, we expect to be north of \$20 million in fiscals 2020 and 2021. That would be growth off of our current expectation of fiscal 2019. So whether the revenue hits as we're expecting it will, or if there's a delay of a quarter or two, as Jim just mentioned, in fiscal 2019, in either case, we would expect fiscal 2020 to have revenue beyond fiscal 2019 for the Navy.

Joe Mondillo: Okay. And fiscal 2019, you're tracking at about what?

Jeff Glajch: We haven't explicitly said that, but we would be somewhere in the mid-teens depending on what happens with the couple of orders that have the potential of being delayed a little.

Joe Mondillo: Okay. Great. All right. Thanks. I'll hop back in the queue in case anyone else has anything.

Jim Lines: Thank you, Joe.

Operator: [Operator Instructions] Our next question is from Bill Baldwin with Baldwin Anthony Securities. Please proceed.

Bill Baldwin: Hey, good morning, Jim and Jeff.

Jim Lines: Hi, Bill. How you've been?

Bill Baldwin: Thank you for your time. A couple of questions here. Jim, it's been a while, but I know at one time you fellows were talking about peak cycle objectives with the revenues I think to target an area of \$200 million. Is that something that you're still referring to, or is that still a benchmark that you're looking at as far as the next cycle peak, or has that changed from the last time you talked about it?

Jim Lines: That certainly is an objective and a goal, and to achieve that will require putting our capital to work through M&A or other forms of business combinations. Organically, in a classic sense, we won't get there without an M&A strategy. But we still have that as where we want to go, where we think we can go. We have the dry powder to get there.

Bill Baldwin: When you model that out, where do you think your gross margins could normalize in a good environment for you? As you look out over the next several years, the cycle is moving up. You're obviously getting a little bit better gross margins in your backlog. I think you indicated you used some capital spending to improve productivity and so forth. Is there a level that we should be using, Jim, looking out for gross margins that would be in the 25% to 30% area rather than 23% to 25% area?

Jim Lines: We still think of our gross margin as a mid-cycle margin in the upper 20s, lower 30s. Now what needs to be borne in mind is the weighting of the naval strategy as we grow, and we are intent on growing that segment of our business. I make that remark because the naval program has a lower gross margin but is accretive or blends in fine at the operating margin line.

So we're less focused on gross margin for the naval strategy, but it blends in at the operating margin line. So I just wanted to make sure everyone is mindful of the naval program because its material intensity does carry a different weighting of gross margin than our ordinary core work.

Jeff Glajch: This is Jeff. Just on top of that, at those gross margin levels that Jim mentioned, the upper 20s to low 30s, the way we think about modeling the business, at that point in time, would be looking at our targeted EBITDA level. We've targeted an EBITDA level of around 17% through a full cycle. We think we would be in the upper teens certainly from the EBITDA margin standpoint, at those margin levels that Jim mentioned.

Bill Baldwin: At mid-cycle, so to speak?

Jeff Glajch: Correct.

Jim Lines: Right.

Bill Baldwin: Right. Okay. Secondly, talking about the Navy, can you give us a little bit of a picture looking out over the next year or two or so, Jim, as to what the horizon looks like as far as potential new Navy orders, in terms of where they might be coming from, the types of projects and the size of the orders potentially?

Jim Lines: There's a high level of enthusiasm in the naval community, the shipyards, the supply chain, the government as well, because of an ambitious program to expand the fleet of naval vessels. So we are expecting, over a longer period of time, to see that create stronger demand for us. To complement that further though, we're not satisfied with the number of components that we're providing the U.S. Navy and our team is tasked with how do we expand our supply, how do we do more work for the U.S. Navy. Should we be successful with that, we see our naval strategy expanding even further. So we have a strong surge of demand that's coming from an expanded build program, and then we intend to complement that by doing more components and supplying additional equipment to the naval programs that we're not currently providing.

Timeframe to do that, I'm not going to cite that, other than we're pretty pleased with where that strategy is going and our tactics to continue to grow our naval revenue, and also the receptiveness from the Navy and their shipyards to what else can Graham do in support of the naval programs.

Bill Baldwin: That's good news. That's super. You guys are doing a good job there.

Jim Lines: Our team is doing a great job.

Bill Baldwin: Absolutely. On the petrochemical and chemical front, I assume that these are some of the programs or projects that are getting pushed to the right. But do you see traction beginning to kick in there as fiscal 2019 proceeds?

Jim Lines: Bill, we think we're in the early stages of the second petchem wave in North America. We do have a number of bids that we've made, some are pretty aged for what we're characterizing as the second wave. We've been hunting these projects for a good while. We think a handful of those close across fiscal 2019 for North American petchem, ethylene capacity, ethylene revamp, downstream derivative plants. So we do have a fairly good dollar size of opportunities that are in front of us over the next few quarters that we are focused on. A lot of resources have gone in to support that selling process, and we expect to be successful on several of those projects.

That's very encouraging because it complements and lays on top of what we think is improving refining fundamentals, on top of where our naval backlog is in terms of its revenue cycle. So, we believe we're at an inflection point, and revenue will begin to expand – it's not hard to do off of a trough, but we're bouncing off the bottom and heading into a more expansionary phase which is why we're bullish on adding to SG&A because we see a multiyear view here.

Bill Baldwin: Absolutely. And lastly, can you give us a little color on what you're seeing internationally as far as refinery, petchem, and so forth, and the sectors geographically, whether it's Europe, Middle East or Latin America, Canada?

Jim Lines: Sure. It's good. We are finally seeing some new capacity projects come into our bid pipeline for the Middle East and for China in the refining space, which we hadn't seen in a couple of years. Some of these are fairly large projects, certainly the ones in the Middle East. China is more typical for their project size.

The timing of these projects is still not yet clear, but what's important is they've entered our bid pipeline. They seem to have strong fundamentals. They have a national interest in some cases for why these refining investments are being made. So we feel very, very good about that. There's a number of those, just not one or two in the Middle East and there are several coming up in China. With respect to South America, if I think of today versus 2013 and 2014, the wave of work that was building up in 2013 and 2014 was just incredible for Latin America. We're not as positive about the timing of projects there today. We still think that sector is going to be contracted for a couple more years.

And Canada, we don't see much in the oil sands area for new capacity although the oil sands for us, once we have the installation, it's a great driver of aftermarket and revamp and metallurgical upgrades. So, we do see that from our installed base. There was just a report that came out today regarding Canada petchem, a massive wave of new investment in Canadian petchem over the next decade. We have some of that work in our pipeline particularly for Alberta, new ethylene projects and expansionary investments there. That's our home turf. We feel very good about those opportunities and our ability to be successful there. Again, that report just came out today which was a very bullish outlook on Canadian petchem investment tied to low-cost natural gas or monetizing their natural resources differently. So, that's very positive.

Bill Baldwin: Very good. Well, congratulations to you and your team, Jim, for a job well done during these tough periods. And now you're in a position to capitalize on all of that hard work.

Jim Lines: Thank you very much, Bill. We appreciate the compliments.

Operator: Our next question is from Gerry Heffernan with Walthausen & Co. Please proceed.

Gerry Heffernan: Good morning, Jim. Good morning, Jeff. Thank you for taking the call.

Jim Lines: Hi, Gerry.

Jeff Glajch: Hey, Gerry.

Gerry Heffernan: In regards to the base business or the revenues that come in during the year that are not really part of the backlog at the end of the year and they're completed before they would be in backlog at the end of the next year, that has stayed relatively steady. I believe you said its 10% above the trough but about 20% below the peak. So understanding that, I was curious to know if that type of business falls into any one particular segment of the four segments that you identify in the press release.

Jim Lines: Sure. It tends to come from our installed petchem base.

Gerry Heffernan: Okay.

Jim Lines: Fair percentages of that sector and also our refining sector. A large percentage of that short cycle work, in and out in a quarter, in and out in a year, is our parts and replacements. That's from our petchem market and that's from our refining market. More than half of it is from those two sectors.

Gerry Heffernan: Okay. And as you just said that a lot of it has to do with the parts and replacement, I presume normal wear and tear stuff that you have a pretty steady order flow on that.

Jim Lines: That's right. Yes. It does have a little bit of variability but nothing like our project work. As we told Joe, we see that level of business typically between \$25 million and \$30 million on a per annum basis, and the parts business is somewhere around half of that.

Gerry Heffernan: Okay. The power segment, obviously a huge challenge in the last year. We have seen the very large increase in backlog. Can you talk to the power segment, how you see things there? Was there anything dramatic in that step-up in backlog which seems to me we've talked to that backlog as being refining and petchem.

Jim Lines: The power sector, to use your verbiage, is challenged. We have seen some improvement in our nuclear power backlog. We haven't seen improvement in our renewables backlog, which is geothermal, waste-to-energy, biomass-to-energy. That can vary as it's tied to legislative policy in North America. But we have seen our nuclear backlog come up off of its bottom over the last several quarters. Renewables is contracted at this point in time.

Gerry Heffernan: Okay. And for you, I would think the renewables would get into the biodiesel and things like that, and the biodiesel tax credit stuff still seems to be mired in D.C. I'm guessing that has some effect on the way that market works for you.

Jim Lines: Yes. Certainly, tax policy, legislative policy can create strong periods of demand, and then also when policy changes, the demand goes away, which is what we've seen over the last number of years. Biodiesel, or green diesel, we tend to put those sales into our chemical industry sales. When we talk about power it's more of electrical generation power, alternative energy, and that context is for power generation.

Gerry Heffernan: Very good. Thank you for the clarification. And one final thing, Jim, you mentioned the early stages of a second wave petchem cycle. And mind you, I will not hold you to the specifics of your answer here. How long would you consider a wave to be? What's the time cycle of a wave?

Jim Lines: What we're reading as this second wave, how we are interpreting what we're reading, and what we're hearing from the marketplace will be more protracted than the first wave, but it won't be the rush of opportunity that we saw 2013 through 2014. That wave spent about 2.5 to 3 years. We think this wave will be more elongated and go from 2018 through 2022.

Gerry Heffernan: I would imagine that a wave of an elongated nature would enable you to handle order flow in a more efficient manner. Is that correct?

Jim Lines: It certainly is helpful to Alan and his team who run the operations, when it doesn't come in a massive surge. The drawback on our sell side is we like the pricing power which comes with the surge. So, it's the yin and the yang of that.

Another element that we've talked about previously on our calls with the second wave, for North America, it has a higher tendency to have international project sponsors. They have an appetite for a different supply chain and a different focus, on first cost versus lifecycle cost. So we're seeing a different margin potential in the second wave than we saw in the first wave.

Gerry Heffernan: Okay. And I greatly appreciate the time you're affording me here. If I can ask one last question in regards to input costs. Can you just give us your view of the effects of metal prices giving our on-again tariff issues, as well as labor pricing and your ability to get labor, and any concerns you may have or what you're seeing as far as compensation wage pressure?

Jim Lines: Sure. On the input cost side, we have seen metal costs rise. We all looked at each other with awe 15 minutes after the tweet went out around the tariffs. Our North American supply chain raised their prices 15% to 20% that day and it is still sticking. However, we've been able to drive that cost increase into our prices and into the market. Where it does come into play, is if we're in the international markets where our competition will not have to deal with a tariff-related cost basis, but we do. Therefore, we could be entering an international sales opportunity with a different cost basis than our competition does.

North America, we're protected because of the tariff, but remarkably, like I cited, in the snap of a finger, certain of our input costs went up 15% to 20% in a morning. We were in front of that. We are watching that. Our supply chain folks did a great job of building up some inventory with a lower cost basis and then also making sure that our estimating team understood the costs of what would be going into inventory or for input costs for future projects. And our goal is to push that cost right into our customers' wallet. So we don't have to deal with that. We've been able to do that.

On the labor side, again, this is illustrative of our longer-term bullish outlook. We're adding to our direct labor force. We have a pretty good ramp-up strategy for that. I am not sensing that there's an impediment in our ability to hire that talent, nor has there been wage pressure, nor that our wages are inappropriate for what the market is asking or what the new hire is asking. So I do expect we'll be able to build out our direct labor workforce in alignment with our capacity needs as we grow.

Gerry Heffernan: That's great. Thank you very much for your time today.

Jim Lines: Thank you, Gerry. Good to hear from you again.

Operator: We now have a follow-up question from Joe Mondillo with Sidoti & Co. Please proceed.

Joe Mondillo: Hi, guys. Just a couple of things. I was wondering if you could update us – I think it was late last year, in the second half of last calendar year, you were talking about how you're working with consultants regarding ways to utilize Graham's capabilities to try to find potential new revenue streams. I was wondering what the outcome of that was, if you found anything.

Jim Lines: The report provided us a perspective on a handful of markets that we're not in currently that would value our operations model, our customer-facing model. One of the highlights that came away is that there likely is more that we can do for the U.S. Navy and related adjacencies to the U.S. Navy. So we're certainly focusing our effort there.

In some of the other areas, as management, we're not quite as certain we belong in those areas, although they have strong growth rates. We're not certain that the pricing is right and the product characteristics match our brand and how we can create value. But it was a very good exercise, a very good process. It came away with a few nuggets for us to think about and it came away with some conclusions that we don't belong in certain markets.

Joe Mondillo: Okay. Great. Actually, that's all from me so I appreciate you taking my follow up.

Jim Lines: You're very welcome.

Operator: Ladies and gentlemen, we have reached the end of our question-and-answer session. I would like to turn the conference back over to management for closing remarks.

Jim Lines: Well, thank you, Cheri, and thank you, everyone, for your time this morning and for your very detailed questions as you asked Jeff and I to clarify our outlook and what's behind some of the numbers. Just as a summary, we're exceptionally excited about where our backlog is. We're very pleased with the quality of our bid pipeline. Our view over the next couple of years is markedly different from where it was 12 to 18 months ago, and we'll update you on our guidance and our outlook as we move into the next quarter and we get this quarter behind us. That helps us set the foundation for where the year can really end up and we'll update you in August.

Thank you very much for your time. You have a good day.

Operator: Thank you. This concludes today's conference. You may disconnect your lines at this time and thank you for your participation.