

Graham Corporation
Fourth Quarter Fiscal Year 2009 Earnings Conference Call
May 29, 2009

Operator: Greetings and welcome to the Graham Corporation fourth quarter fiscal year 2009 earnings conference call. It is now my pleasure to introduce your host Mrs. Deborah Pawlowski, IR for Graham Corporation. Thank you Mrs. Pawlowski, you may now begin.

Deborah Pawlowski: Thank you and good morning everyone. We appreciate your joining us today on Graham Corporation's Fiscal 2009 Year-End Financial Results call. On the call I have with me today, Jim Lines, President and CEO of Graham, and Jeff Glajch, Chief Financial Officer. Join me in welcoming Jeff on his first conference call with Graham. Jeff joined Graham as CFO at the beginning of March this year, succeeding Ron Hansen who retired in August of 2008. Some of you may have already met Jeff, however, as we have been getting him out on the road quite a bit already to meet investors. Jim and Jeff will be reviewing the results of the fourth quarter and fiscal year, as well as the company's strategy and outlook during this contraction in the business cycle. You should have a copy of the earnings release that was put out this morning. If not, you can access it at the company's website, which is www.graham-mfg.com. In addition we have posted supplemental slides on the website that provide a visual overview of some of the results for the year and the quarters.

As you are aware, we may make some forward-looking statements during the formal 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 that could cause actual results to differ from what was stated here today. These risks and uncertainties and other factors are provided in the earnings release, as well as other documents filed by the company with the Securities and Exchange Commission. These documents can be found at the company's website or also at www.sec.gov.

With that let me turn it over to Jim to begin the discussion.

Jim Lines: Thank you, Debbie, and good morning everyone. I will provide introductory comments regarding fiscal 2009 results, give a little color about the outlook for fiscal 2010 and beyond, and then Jeff will provide details for the fourth quarter and fiscal 2009, and some comment on 2010.

I'm extremely pleased by our performance in fiscal 2009, and I wish to acknowledge and thank our employees for their resourcefulness, dedication, and careful execution of our strategies, their commitment to implement process improvements across the company, and their focus to improve cash management. As a result of their

efforts, we were able to take full advantage of the strong market conditions we have enjoyed the past several years, standard manufacturing and engineering capacity, and measurably improve our operating and financial performance.

Several records were set in 2009. Sales exceeded \$100 million, up from \$86 million last year. Net income and diluted earnings per share were both records, with net income at \$17.5 million and diluted earnings per share of \$1.71, up from \$15 million in net income for fiscal 2008. Operating working capital averaged 5% of sales for fiscal 2009, which compares with 9% in fiscal 2008, and 14% in 2007. Inventory turns increased to greater than 12 times per year, up from 11 last year, and significantly up from 4 to 6 turns, just a few short years ago.

The year, 2009, was a great one for our company, but it was also a year of continued investment to improve Graham. Our management team and employees understand that the company must deliver solid operating performance, while we concurrently drive improvements across the company to expand capacity, reduce our lead times, and improve the quality of our products and services provided to customers. 2009 represented another year where we successfully executed on both fronts.

Highlights of the advancements we made were: a measurable improvement to on-time delivery, with current on-time delivery above 92%; our capital investment provided approximately a 5% gain in productivity; and our capability to effectively outsource production improved, as 11% of production was outsourced last year, including production done in Asia and in North America. We strengthened our market position in China for oil refining applications. Approximately 6% of sales in 2009 were incremental, due to our China strategy. Engineering automation and 3-D modeling progressed as scheduled for surface condensers and ejector systems, and our continued alignment of business processes to improve efficiency contributed to our strong performance and our flexibility.

I am also pleased with how the company responded to adverse and abrupt changes in our markets mid-year. There was considerable disruption to backlog continuity, as our customers cancelled three projects totaling \$3.3 million, placed another five projects on hold totaling \$4.4 million, while various other orders in backlog also had customer-initiated changes to delivery schedule. Our employees acted quickly to re-align project schedules so that production continuity was preserved and operating efficiencies maintained.

In addition, as the order rate dropped starting in the third quarter, our managers acted swiftly to the market change and adjusted our cost structure to reflect this change in our markets. Approximately \$2.7 million in

annual savings will be realized as a result of the restructuring. The steps taken to adjust our costs were difficult, but necessary, in light of the abrupt changes in our markets. Those steps, along with our approach to managing the business during the growth surge of 2005 through mid-2009, the improvements in our company, and our solid financial position, put Graham in an excellent position as we are well-prepared to weather this market downturn.

We will continue to invest in the company during the downturn to make certain we are where the company needs to be when our markets recover. Our sight is set on the next up cycle, and how we can gain additional market share, add geographic diversity to our sales mix, provide additional products and services, and improve further our operating performance. I am confident that we can effectively manage through this downturn and position our company for the up cycle.

These are challenging times in our industries, as capital spending has been dramatically cut. We are aggressively pursuing what work is available. Nonetheless, for this contraction, I expect that year-over-year revenue may decline by 30% to 40%, not dissimilar from past declines. However, I believe the company will perform much differently during this downturn than it had in prior downturns, and in a very strong way.

Jeff will comment on margin expectations for the year. Our pipeline of large projects that can lead to future orders remains active. In general, our sales and application engineering personnel have remained busy during the past three quarters. There hasn't been much change. You can identify between \$125 and \$150 million of live projects that require \$250,000 or more of Graham equipment. This figure hasn't changed much over the last several quarters. What does remain difficult to predict is when the purchase decisions will be made for this work. I expect order intake during the next several quarters to vary greatly from one quarter to the next.

We believe major project work in the Middle East, Asia, and South America will become active before the domestic markets begin to recover. As a matter of fact, there are several refining and petrochemical projects that are expected to commence equipment procurement in the coming quarters. Again, these are large projects in the Middle East, Asia, and South America.

Our sales and engineering personnel continue to develop relationships with decision-makers for these projects to position our company when procurement decisions will be made. The underlying fundamentals that create increased demand for energy products have not changed. Certainly it is a challenging environment in the short-term; however, our view regarding energy markets over the next 20 years has not changed. We are

prepared for the short-term challenges, I believe, more so now than in the past, and our strategies regarding long-term growth and sustained business improvement are intact.

I will now turn it over to Jeff Glajch. Jeff has gotten on board quickly, and is an excellent addition to our executive team. So welcome Jeff, to your first conference call with our investors.

Jeff Glajch: Thank you, Jim, and good morning everyone. I'll start with a review of sales and order activity before moving on to operations.

Net sales in the fourth quarter of fiscal 2009 were \$24.8 million, compared with \$22.8 million in the fourth quarter of fiscal 2008. As most of you are aware, quarter-by-quarter sales can be lumpy for us, given the magnitude of our orders coupled with the high variability that can occur in engineered-to-order manufacturing.

Sales advances in the fourth quarter reflected the strong order activity that Graham had in the latter half of fiscal 2008 and the first half of this past fiscal year. Ejector and condenser sales increased 22.6% and 27.3%, respectively, in the quarter, compared with last year's fourth quarter, while all other product categories decreased 11.9% on a quarter-to-quarter basis. The increases in ejector and condenser sales, which combined represent two-thirds of Graham's total revenue, was a result of the strong demand we had seen in the refinery, petrochemical, and alternative energy markets before the sudden slowdown in the second half of last year.

By industry, 37% of sales in the fourth quarter of fiscal 2009 were to refineries, compared with 33% in the same period last year. Thirty five percent of sales, were to the chemical and petrochemical industries, up from 32%, and 28% were to the power industry and other industrial applications, down from 35%.

Graham sales to the U.S. market were very strong in the fourth quarter of fiscal 2009 at \$15.8 million, up \$4.4 million, or 38.4%, above last year's fourth quarter, and represented 64% of total sales. Again, this growth was driven by the strength of the U.S. refining and petrochemical markets. Offsetting this increase was a \$2.4 million, or 20.3%, decline in international sales to \$9 million. In the quarter we saw weakness in South America, Western Europe, and the Middle East.

For fiscal 2009, total net sales increased 17% to a record of \$101.1 million, compared with \$86.4 million in fiscal 2008. We saw increased sales in all product groups with condensers increasing 8.2% to \$22.9 million,

and ejector sales advancing 5% to \$38.5 million. After-market, heat exchanger and pump packages sales advanced a strong 38.9% to \$39.7 million.

In fiscal 2009, 46% of sales were to the refining industry, 27% were to the chemical and petrochemical industries, and 27% were to the power industry and other industrial applications. This was similar to 2008 with slightly higher weighting toward the refining industry. U.S. sales for fiscal 2009 were 63% of total sales, up from 54% in fiscal 2008. As Jim mentioned earlier, we expect moving forward to see higher levels of international sales and that was reflected in our most recent order mix.

Looking at orders and backlog, we received \$20.5 million of net orders in the fourth quarter fiscal 2009, down from \$35.1 million in the same period last year. Fourth quarter orders were well ahead of the \$8.1 million Graham received in orders during the trailing third quarter. We recommend not focusing on one quarter's worth of orders, but rather the trailing 12 month order level. In this regard for fiscal 2009, we received \$73.9 million in orders, down from \$107.1 million in fiscal 2008, with all of the fall-off occurring in the second half of the year.

Geographically, fourth quarter orders decreased across most regions, led by the U.S. The most notable exceptions were orders in the Middle East, which saw a strong increase for the second consecutive quarter. Orders received from customers in Africa were also up significantly for the quarter. For fiscal 2009, this pattern held true with the inclusion of Asian orders, which were also very strong, but this occurred primarily in the first quarter. U.S. orders for the fourth quarter represented 37% of the total, compared with 67% in the fiscal 2008 fourth quarter. For fiscal 2009, U.S. orders comprised 43% of total orders, down from 70% last year.

At the end of the year, the backlog was \$48.3 million, down 36%, compared with \$75.7 million at the end of fiscal 2008. The quarter-end backlog number excluded \$3.3 million related to three cancelled projects, but included in the backlog is approximately \$4.4 million in orders related to suspended projects. Thirty-eight percent of projects in the backlog are for refineries, 35% for chemical and petrochemical, and 27% for power and other industrial applications. The backlog at the end of fiscal 2008 was much more weighted toward refineries, with nearly one-half of the backlog in that area. We expect 90% of our existing backlog to ship in the next 12 months.

Looking at Graham's operational and bottom line performance for the quarter and fiscal year, our net income was \$3.6 million in the fourth quarter of fiscal 2009, down 14.6% from \$4.2 million in the fiscal 2008 fourth

quarter. Earnings per diluted share came in at \$0.35, \$0.06 below last year's fourth quarter EPS of \$0.41. For the full fiscal year, net income and earnings per share were at record levels. Net income was \$17.5 million, 15.2% above net income of \$15 million in fiscal 2008, while diluted EPS was \$1.71, 14.8% above the \$1.49 achieved in fiscal 2008.

Gross profit in the fourth quarter was \$9.6 million, compared with \$8.9 million in last year's fourth quarter. The gross margin percentage in the quarter declined slightly to 38.8% of sales, compared with 39.3% in the fiscal 2008 fourth quarter. However, the gross margin was improved from the 37.9% achieved in the trailing third quarter of fiscal 2009. For fiscal 2009, gross margin was at 41.3%, compared with 39.5% in fiscal 2008. Better product mix and operational improvements in engineering and manufacturing contributed to the year-over-year increase.

I would like to point out that as our sales in the next several quarters are negatively affected by the recession, we do not see the recent gross margin levels as sustainable and think margins will likely decline to the 28% to 31% range for fiscal 2010. In the fourth quarter, Graham took the difficult but necessary steps to restructure our cost base. We recognized \$559,000 of restructuring expenses, primarily severance costs. As Jim mentioned earlier, this action will reduce our manufacturing SG&A costs by a total of \$2.7 million in fiscal 2010. SG&A as a percentage of sales declined to 14.1% in the fourth quarter of fiscal 2009, compared with 14.8% in the fourth quarter of fiscal 2008, and 14.4% in the trailing third quarter of fiscal 2009.

For fiscal 2009, SG&A expenses were \$14.8 million, or 14.7% of sales, compared with \$13.1 million, or 15.1% of sales in fiscal 2008. The increase in dollars is related to higher variable compensation costs associated with a significant sales and net income improvement. We expect that SG&A for fiscal 2010 will be down from 2009, at \$13 to \$14 million.

Interest income in the fourth quarter of fiscal 2009 declined to \$30,000, compared with \$227,000 in the same period last year, primarily as a result of the significant decline in U.S. treasury yields. Our investments are in U.S. treasury securities with maturities of 91 to 180 days. Our effective tax rate for fiscal 2009 was 35%, up from 32% last year. We estimate our effective tax rate for fiscal 2010 to be approximately 34%.

We've built-up a large cash reserve during the strong part of the business cycle. Cash, cash equivalents, and investments were at a record level of \$46.2 million at March 31, 2009, up from \$36.8 million at March 31, 2008, and relatively unchanged from \$45.4 million at the end of the trailing third

fiscal quarter. We have no borrowings on our \$30 million bank line, utilizing it solely for outstanding letters of credit. Our increased focus on cash management from the point-of-sale through delivery has reduced our cash conversion cycle to 17 days, which is an all-time low for Graham. We believe we are financially well-positioned to weather this downturn.

Net cash provided by operations was \$11 million in fiscal 2009, compared with \$19.7 million for fiscal 2008. The increase in sales in 2009 affected our working capital requirements relative to 2008. We also saw an increase in income taxes paid on our higher fiscal 2009 net income, and we made a significant \$7.5 million contribution to Graham's defined benefit pension plan. We do not expect to need to fund our pension plan in 2010.

Capital expenditures increased to \$1.5 million in fiscal 2009, compared with \$1 million in fiscal 2008. However, we had previously estimated the capital expenditures for the year to be in the \$1.8 - \$2 million range. We adjusted our spending plans downward in the fourth quarter, as the looming recession was evident. The fourth quarter capital expenditures were \$299,000, compared with \$368,000 in last year's fourth quarter. Capital expenditures for fiscal 2010 are expected to be approximately \$1 million; 65% will be allocated for machinery and equipment, 28% for information technology upgrades, and 7% for other improvements. Approximately 50% of our fiscal 2010 capital spending is expected to be for productivity improvements and the balance will be used for capitalized maintenance and other general purposes.

That concludes my remarks. Jim, I will turn it back to you.

Jim Lines: Thank you, Jeff. At this time, we will take your questions.

Operator: Thank you. Our first question comes from Rick Hoss from Roth Capital Partners.

Rick Hoss: Hi, good morning everybody. Jim, you talked about the new order environment being fairly stable and comparable to years past, at least at the proposal level. What's keeping people from signing contracts? Is it credit or is it uncertainty in energy markets? And, what's the view on project costs and the expectations for those to decrease further or to stabilize?

Jim Lines: Hi Rick. What we're hearing from our customers is that the project costs still remain a problem relative to the price of oil, and that's affecting the return on investment for these massive projects. It's believed

by our customers that the costs for the projects will continue to come down. They have come down some, between 15% to 20% over the last six months, and they anticipate they will come down further. In addition, more of a short-term issue is what does the demand profile look like? Refinery utilization, as an example, is low compared to where it had been last year or two years ago. So, there is some capacity within the refinery to soak up additional demand before investment is needed. But, again, we continue to hear long-term from our customers that investments need to be made to keep up with increasing demand for energy-related products, and this is a short-term issue that will right itself over time.

Rick Hoss: As far as gross margins go, you gave the range of 28% - 31%. How much is the decrease attributable to bidding on less profitable projects?

Jim Lines: If you think about the sales mix, as Jeff described it, becoming more weighted toward international, we've talked in the past that sales mix has an impact on gross margin. U.S. projects, in particular U.S. refining and petrochemical projects, have better gross margin potential than Asian projects. We think the recovery will be started in the Middle East and Asia, followed by South America. So, there is a mix component there that is affecting the margin potential. In addition, in an environment where there are fewer projects proceeding at a given point in time, the competitive landscape becomes more fierce, and that has an effect on margin as well. So there are two aspects to it: one is geographic sales mix, the other is the selling environment at this particular point in time.

Rick Hoss: Jeff, when you first showed up at Graham, what jumped out at you as the greatest opportunity or what gets you most excited about this business?

Jeffrey Glajch: If you look at the long-term outlook for this business, while the short-term is a little bumpy, long-term there is the need for increased energy around the world, and Graham is well-positioned in that regard. Secondly, looking at Graham's balance sheet, we have a very strong balance sheet and the opportunity to potentially utilize that balance sheet to expand either internationally or domestically. I think both of those areas are very exciting to us. Finally, the first thing that really popped out at me was the quality of the management team and the strength of the employees. We've got a very deep management team with a lot of experience within this industry, specifically a lot of experience within Graham. Combine that with the business factors around here, and I think we've got a very strong future.

Rick Hoss: Thank you very much for taking my questions.

Operator: Our next question is coming from James Bank from Sidoti & Company.

James Bank: Hi. Jim, I believe, and please correct me if I'm wrong, in the fourth quarter of fiscal 2009 just reported, I thought the guidance was roughly 28% - 32% for gross margin. If that was the case, I was just wondering what surprised you here in the fourth quarter?

Jim Lines: I just want to clarify the question. You felt the guidance in the fourth quarter for financial performance was to be between 28% and 32%?

James Bank: I believe so. I'm trying to reach back and remember because I noticed that international sales was up, and I guess that was probably partly attributable to the margin in the fourth quarter. To me, it blew out my expectations of what you were going to do for gross margin 4Q fiscal 2009. Was there anything there that surprised you, given that guidance that you had leading into the quarter?

Jim Lines: I don't recall, James, specifically giving guidance for the quarter. We did come in within the range that we had given for the full year which was 39% to 42%. From that perspective, it was right in line with what we had said for the full year on average. We don't give guidance quarter-by-quarter because of the lumpiness of our business.

James Bank: Okay, my mistake. I was wondering, then, if you could speak to April order trends, by any chance?

Jim Lines: The market is a tough environment right now. I'd say the April order trends were soft. We have given guidance that we should expect from quarter-to-quarter significant variability. That's not to say that the coming quarter is going to be low by comparison to the prior quarter. We just don't have all the details yet, but April has started out slowly.

James Bank: Fair enough, thank you. The backlog, the \$4.4 million of work, is there a timeframe at all for that work that has been put on hold when these people need to let you know or is that an indefinite delay?

Jim Lines: They're on hold, pending notification from our customers that they want to reinitiate the projects. We have not been advised at this point for the five contracts totaling \$4.4 million that are on hold that there is

risk of cancellation. It's a difficult environment for our customers, even for orders that are moving through backlog, we are seeing changes in delivery schedules being initiated by our customers, just because they're slowing down their projects; they're preserving their capital.

They are pushing out their time lines to erect these facilities by one or two years, and that's affecting the pacing of production of equipment or the need for equipment at the site. It's difficult for us to project when the projects on hold will get released. At this point we continue to stay in contact with our customers for those five projects. All I can say at this point is that we have not been advised that they are moving toward cancellation.

James Bank: I don't know if you talked about this earlier in your prepared remarks, but are these more in the chemical sector, refining sector, or an aggregate of all your sectors?

Jim Lines: It was refining.

James Bank: And the \$2.7 million in savings, Jeff, you said that was coming from SG&A?

Jeffrey Glajch: Both SG&A and from operations.

James Bank: Is there a breakdown mix we can have?

Jim Lines: No, we don't disclose that.

James Bank: That's fine, fair enough, thank you.

Deborah Pawlowski: James, we did provide some understanding of what we expect SG&A to be.

James Bank: Right. Did I hear it was like \$13 to \$14 million?

Deborah Pawlowski: Correct.

James Bank: And then a macro question. Jim, if you could comment on the nuclear front, which is probably more of an international opportunity, what's going there? Are you becoming any more enthusiastic about potential acquisitions, and what you're going to use this cash for? I know that's something I have asked on

every single conference call, but if I could get an update, that would be terrific.

Jim Lines: You are consistent. Regarding the nuclear market, particularly in the U.S., we have seen that slow down. We think that's an effect of the tight credit market. It is a difficult projection as to when nuclear will take-off in the U.S. market. Regarding the nuclear energy market internationally, our sights were focused on the growth that was going to come from the North American fleet that was going to come under construction over the next decade or so. Regarding the acquisition front, I would like to turn it over to Jeff.

Jeff Glajch: James, on the acquisition side we are continuing to look at potential opportunities both domestically and internationally. We're strategically looking at the opportunity to geographically expand our base, primarily in the same arena that we are in now. Domestically and internationally, we are potentially looking at product line expansion. One of the concerns that we have right now, and the patience that we believe we need to show, is that from a valuation standpoint, we're still seeing valuations a bit higher than we would expect. People are looking back a lot more than they're looking forward right now. We want to be very careful that we strategically make the right decision, and once we have identified the right strategic decision to make, that we don't overpay.

James Bank: I certainly appreciate and recognize the discipline. I think you guys have one of the best balance sheets of any company I cover. Thank you very much, I appreciate your taking my calls.

Operator: Our next question is coming from Dick Ryan from Dougherty.

Dick Ryan: Good morning. Jim, when you talk about the gross margin holding up better this time than in previous down cycles, is that primarily due to a higher percentage of smaller projects in the mix? What does the pipeline look like with the smaller projects versus larger projects that may be more competitive?

Jim Lines: That's a good question Dick. Sales mix does have an effect. Smaller projects tend to have higher gross margins. But I would say that what has caused improvement going forward in our gross margin, when you compare Graham to how it looked in the past, has been the capital plan that we had, the productivity and efficiency that we've put into the business over the last four years, and our ability to execute more efficiently as a company than we have in the past. Sales mix varies from period to period, but our business will perform differently than it had in the past. I think that's the largest contributor to the improvement in gross margin.

Dick Ryan: When you talk about your customers and their outlook for further declines in cost, do you get a sense of what they're trying to evaluate in coming to that conclusion? For instance, Alcoa made a presentation today and indicated that there has been tremendous de-stocking and inventories are at record lows. Do you get a sense that those expectations for lower costs are reasonable or what is the sensitivity there?

Jim Lines: Initially, in our third quarter, what we heard from our customers as they began to delay purchase decisions was that by waiting six to twelve months, they expected to get from 10% to 20% reduction in the cost of their projects. I believe, at this time, they've been able to realize virtually all of that and are still expecting additional reduction in costs to be realized over the next few quarters.

Looking at the commodity prices for the raw materials that go into the equipment and the erection of the facility (carbon steel, nickel-based alloys, and copper-based alloys), they have all come down pretty significantly over the last several quarters.

Operator: Our next question is coming from George Melas from MKH Management.

George Melas: Good morning. I have a question on visibility. If I go back to the end of last year, and look at your backlog at that time and the revenue that you reported in fiscal 2009, assuming that 90% of that backlog shipped over the next 12 months, you get a visibility of, roughly, two-thirds of the coming revenue. If you take your revenue in fiscal 2010, down roughly 35%, to the mid-range of the 30% to 40%, and look at your backlog, and multiply it by 90%, it's about the same. So is that a good look at the business? The backlog that you enter a year with roughly two-thirds of the revenue with very good visibility from your backlog. But you have to sell the other third, and what would that other third be? How much of that would be after-market work, and how much would be work that you have to book during that 12 months?

Jim Lines: The analysis that you've done George is fairly accurate, and it has held up over the last couple of years.

The additional business-to-book comes from our smaller products. Backlog at a given point in time, such as at the end of a quarter, has about one-quarter's worth of small product sales. Therefore, we have three more quarters of small product sales to book to affect a given fiscal year, if talking in the first quarter. In addition to that, there are large projects to be won that can be converted into revenue during the course of the year. We believe somewhere up through mid-October it's possible to convert a portion of a large project to revenue

before March 31.

George Melas: What portion of your revenue did you expect in fiscal 2010 could be from after-market, from just parts? I don't know if you call that a very small project, but small orders?

Jim Lines: After-market has typically been between 16% to 18% of revenue. Last year, 2009, it was around 20% of revenue. We have an extraordinarily large, one-time capital spare order that we've indicated when we won it, so don't we don't consider it repeatable. I would think in terms of 16% to 18% of our revenue as after-market.

George Melas: Would that be included in your backlog?

Jim Lines: Yes, that's part of that backlog I referred to as coming out in one quarter. It typically converts in one quarter.

George Melas: Thank you very much.

Operator: Our next question is coming from John Bair from SKA Financial Services Inc.

John Bair: Good morning. Just a bit of a follow-up to a previous question. Are you seeing any increases in interest in the after-market, given that so many of your projects are being drawn-out or a few cancellations? Are you seeing any increase in that trend?

Jim Lines: Actually we hadn't, and in talking to our customers, we're finding customers whose strategy during this time of downturn is driving operational efficiency to gain leverage from the existing plant and capital preservation. So, we have, not significantly, but have begun to see some slowing of after-market orders.

John Bair: In other markets outside of the refining and chemical petrochemical areas, do you see opportunities where you might be able to focus a little bit more on, like the food processing or power? I guess I'm thinking in the ideas of something particularly in some of the emerging market areas, whether it is Latin America or Asia Pacific or wherever?

Jim Lines: We see opportunity, and it will be intermittent, coming from the fertilizer market. That's Asia,

Middle East, and some South America, also in edible oils; those are smaller projects, but there's some demand coming from edible oils and oleo chemicals. Power generation is linked very closely to the credit market, and we've seen some slowing in the power market. Our customers have indicated they're pulling back on investment there.

John Bair: In a big picture sense, with the big emphasis toward higher fuel efficiency for vehicles and so forth, looking out in the longer-term, how do you try to assimilate that into your projections as far as it would impact large-scale projects of new complexes, refining complexes or what not? Can you factor that in or do you look at that in any way?

Jim Lines: We see that as a component that will require mandatory cap ex at an existing refinery to produce more efficient transportation fuels; that could lead to need for our products. Also along those lines, are cleaner transportation fuels, lower sulfur content in gasoline, lower sulfur content in diesel. That also creates demand for our products, our ejector systems and our condensers. The need for, or the drive for, a smaller environmental footprint from transportation fuel moves globally with a timeframe in each region, but that does create demand for our products.

Operator: Our next question is coming from Tim Evnin, who is a Private Investor.

Tim Evnin: A couple of my questions have been asked, I'll ask them perhaps in a slightly different fashion, so I appreciate your patience. On the after-market business, how closely is it tied to capacity? Is it more capacity utilization or time for your clients, in the sense of, how much is deferrable and how much is tied to how fast they're running their factories and facilities?

Jim Lines: Under normal circumstances it's normally time based. A refinery's, desire, once they have started up and are running, is to run continuously for five years without an unscheduled shutdown. They plan the shutdown one or two years in advance of the actual planned turnaround, and that's when they begin to inquire for spare parts. If there is an erosion or corrosion problem that brings an unscheduled shutdown, that's hard for the refiner to plan. It's hard for us to plan, but that happens as well. The equipment may have a performance problem due to damage from corrosion or erosion or just mal-operation of the equipment.

Tim Evnin: So, it's known, other than unscheduled, which is a substantially smaller portion?

Jim Lines: Right.

Tim Evnin: On the balance sheet, your buy-back, as I understand it, was quite strategic and at excellent prices. Could you give some further color to your thinking about share re-purchase, completing the authorization, versus acquisition and how you balance those two? And, think about the returns you demand on putting that money to work?

Jeff Glajch: Sure. I think there were a couple of questions there. First of all, with regard to our share re-purchase, we did authorize up to one million shares to be purchased between the end of January and late July 2009. As you've noted, we've repurchased in the fourth quarter of fiscal 2009, 277,000 shares. So, we have gone part of the way down that path. That repurchase does remain open through late July.

With regard to the conflicting utilization of the cash between a share repurchase and acquisitions, when we laid the share repurchase out back in January, we did it with the understanding that it was a good utilization of our cash at the time, but that it would not impede us in any way in making acquisitions. To date we've spent a portion of the funds, about \$2.3 million, repurchasing shares through the end of March. We certainly have the opportunity to utilize more cash if we so choose to re-purchase shares, but in no way will that impede our ability to make acquisitions.

Tim Evnin: So, order of preference for the business would be, not to put words in your mouth, irrespective of potential return, acquisitions first, share re-purchase second?

Jim Lines: Yes.

Jeff Glajch: I think that your last question of your original set of questions was on our return criteria for acquisitions. We clearly want to generate a return in excess of our cost of capital, so to make an acquisition accretive for U.S. would be relatively straight-forward, given the returns we're currently getting on that cash and investment sitting on our balance sheet. That's not our target. I mean, obviously, we want to be accretive, but our real target is to ensure that over the short- and long-term, we're generating a return in excess of our cost of capital.

Tim Evnin: Just a last question on large-scale desalinization or large-scale water treatment, do you have any exposure there?

Jim Lines: We have provided equipment for desalination projects over the years. They require our ejector systems and, at times, our vacuum pump packages.

Operator: Our next question comes from George Walsh from Gilford Securities.

George Walsh: I just have a couple of follow-up questions relating to earlier questions. One, Jim, relative to raw material cost, obviously there are a lot of factors impacting things around the world with projects, but would you say that is probably the top decision factor in terms of delays with projects or even cancellations?

Jim Lines: Yes, I believe so George.

George Walsh: Given that, do you think that it's a matter of if these types of prices stabilize, that these projects would go from pipeline to orders or would be revitalized? Or that prices actually have to reverse trend so they feel like they don't want to get caught on the other end?

Jim Lines: I think it has to result in the raw material prices stabilizing at a level around where they are. Perhaps a little bit lower. I don't necessarily think it's the price of oil, per se, because when this wave of business took off in 2004 - 2005, oil was \$30-ish a barrel. And there was tremendous demand for our products, 2005, 2006, 2007 and 2008, 2005 and 2006 when oil was less expensive than it was the last two years. So it comes down to the cost of the facilities and how that's aligned with the raw material costs.

George Walsh: Yes, because I would think that the dynamics and profitability are still very strong in these, particularly with the drop-off in raw material cost?

Jim Lines: I tend to agree with what you're saying.

George Walsh: To clarify on the SG&A, you said there were \$2.7 million in cost-savings you would be getting? Is that correct?

Jeff Glajch: That's correct, but that's in both SG&A and operations.

George Walsh: I was matching that up to the SG&A number versus this year.

Jeffrey Glajch: A significant portion of the savings is in operations also.

George Walsh: All right, and you went through the M&A which was good relative to the great strength of your balance sheet. Is there anything on the organic side you could expand upon in terms of investments that you would be thinking about to take advantage of the slowdown in the cycle? Would you want to make investments in marketing or new offices around the world or any other type of investments?

Jim Lines: That's a great question. One of the factors that is leading to our SG&A being where it is in proportion to sales during this downturn, is that we've chosen to use this downturn to increase our emphasis on sales and marketing, to prepare the business to grow organically or take greater market share, as the markets recover. We chose not to strip away in our SG&A area to negatively affect our potential for growth when the market recovers.

George Walsh: It seems even as you've had to ramp up for the good part of the cycle, you're still somewhat modular with your costs you're able to adjust.

Jeffrey Glajch: George, absolutely. In fact, if you look at how Graham grew through this up cycle, we invested in variable costs. What I mean by that is, instead of running two shifts we ran three shifts, and if we had a situation where we had excess demand compared to our capacity, we would outsource some of our production. We did not invest and expand our roofline, so we did not add buildings, we did improve our throughput of our facility, but we did not expand our capacity by putting in an extra building or an extra facility, and so we expanded using variable cost and when the demand is coming back down a little bit, we're able to contract those variable costs.

George Walsh: Right and during that period, you had great increases in efficiency and productivity.

Jeffrey Glajch: Absolutely. We've spent a lot of effort improving the speed of our entire work process, our work flow, before manufacturing and during the entire manufacturing process, and we expect to continue to focus on that during this weaker time period, so that as we come out of this, we'll be even faster and stronger.

George Walsh: Well you've done a good job in the up cycle and you've got a great balance sheet there, so you should be in good shape. Thanks a lot.

Operator: At this time we have no further questions. I'd like to turn the call back over to Mr. Lines for any closing comments.

Jim Lines: Thank you. Again, we appreciate your time and interest in Graham. As we've discussed, although the near-term is challenging, we feel extremely comfortable with our financial strength, the strength of our brand, and capability of our company to do relatively well, all things considered during this contraction in our markets. We also know that we are better positioned for the up-turn in our industry, when it does come, and we believe we can capture an even larger share than we had this last cycle. Thank you for your time and enjoy the weekend.