

Jim Lines is CEO of Graham Corporation. Graham Corporation manufactures custom-built vacuum and heat transfer equipment. Their products include steam jet ejectors, vacuum systems, surface condensers for steam turbines, vacuum pumps, compressors, and heat exchangers. They are used in a variety of industries including chemical, petrochemical, fertilizer, pharmaceutical, plastic, LNG, and other process industries. By way of background, Graham has 10 million shares outstanding at about \$10 a share, a \$100 million market value. The company has \$45 million of net cash giving it a \$60 million net capitalization. Jim is going to give us a great insight about Graham.

Jim Lines, President and Chief Executive Officer

Thanks, and good afternoon. I'm happy to be here to overview the Graham story, which has been a wonderful story to tell over the last couple of years. Even as we face the market downturn, we are very well prepared. We are thinking about coming through the downturn on the other side as a stronger company and using it as an opportunity to strengthen Graham.

As Jim said, we have 10 million shares through a series of two splits. We've increased our number of shares; initially with a five-for-four and then, recently, a two-for-one. Ownership of our stock currently is about 75% held by institutions and just under 4% by insiders. We are a 73-year old company with revenue targeted to be around \$100 million for our fiscal year ending March 31, 2009, which we call fiscal year 2009.

We are a provider of engineered-to-order products to the process industries, primarily to refining, petrochemical, and power generation. We feel it is these industries that reward engineering know-how, product differentiation, a strong customer-focused consultative sales model, and they make decisions in these markets based on value rather than price.

Two-thirds of our revenue, on average, comes from ejector systems and surface condensers. We are commonly asked, what is an ejector? What does it do? In the lower left-hand corner is a distillation column in a refinery. The structure on the right side of the picture is about 50-feet in diameter and stands about 100 feet tall. Our ejector systems create a sub-atmospheric condition inside that very tall vessel that will enable oil to boil at a lower temperature than it would normally. You might think of water on the stove boiling at 212 degrees at atmospheric pressure, but water can also boil at 50 degrees Fahrenheit if the pressure were lowered. So, our equipment lowers the pressure which allows the refining process to be done more efficiently and more completely. Surface condensers have one primary application; they support a steam turbine. The steam turbine could be used in association with a generator to produce the electricity for power generation or attached to a mechanical device, such as a compressor, pump, or blower. Our equipment is very critical to the operation of the refinery or of a petrochemical plant or a power generating facility.

Looking at our sales mix, we consider ourselves an international company as about 50% of our revenue is from international markets. Right now it's about one-third international, two-thirds domestic, because of the strength of the North American refining activity over the last couple of years. But we consider ourselves roughly 50% international and 50% domestic. More importantly, projecting our company forward three or four years from now, you could think of us as 60% international, 40% domestic.

We do have a rich history as a 73-year old company with a large installed base of our products. Aftermarket provides about 20% of revenue. Ejector systems represent about one-half of the aftermarket sales. We like ejector system sales. We drive ejector system new unit sales because we recognize that two, five, even 15 years after the shipment, we will receive aftermarket orders.

As I mentioned, we sell into the refining, petrochem, and power generation markets. We also sell into a host of other markets requiring mass transfer, heat transfer applications, such as pharmaceuticals, and edible oils. This slide gives you a little more color on where our products are used. In oil refining, our equipment is used for conventional crude oil, oil sands in Alberta, extra-heavy crude oils in Venezuela, and sour crude and lube oil fractionation. Chemical processing is a very broad umbrella; there are many markets our products are used in. Ethylene, ammonia, nitrogen, and methanol are feedstock commodity petrochemicals. Those plants require significant amounts of our equipment. But it is equally important that those plants provide the feedstock for the downstream petrochemical facilities that produce things that you and I use every day: CDs, our clothing, and almost anything in this room that you can think about probably originated from a fossil-based product.

Downstream of the ethylene, ammonia, nitrogen, and methanol plant will be styrene, polystyrene, ethylene glycol, and alcohol plants. They are vacuum-intensive, requiring our ejector systems, including vacuum pumps, heat transfer products, as well as our condensers. Also, chemical processing includes coal-to-liquids and gas-to-liquids. Our company has been involved in coal-to-liquids applications since the 1970s with a coal-to-gasification, or chemicals in the 1980s. We have some orders in our backlog for coal-to-liquids for China. We also have recently supplied a very large project to Qatar for a gas-to-liquids facility.

You will recall that in power generation, our condensers support the steam turbine. The steam cycle we typically associate with is below 75 megawatts. That would be a cogeneration type of application: waste-to-energy, geothermal for institutional sales, or combined heat power and light applications. In the past we have also supplied the nuclear power market and will do so in the future.

Other applications for our equipment in markets where we have a strong position include edible oils and oleo chemicals for such companies as Proctor and Gamble, Archer Daniels Midland; Cargill; ethanol; bio-diesel; heating, ventilating, and air-conditioning markets (HVAC); industrial gases (air products - BOC) and cryogenic applications require our products.

This gives you a sense of recent orders our company has won, their geographic locations and end-use market. We recently won a large order for a North African fertilizer project. That's driven by population growth and is a very specialized application. There are only a few companies in the world like Graham. There are only two others like Graham that can provide equipment to a fertilizer project.

In China, we have an order in our backlog for a \$3.5 million refinery being built by PetroChina. South Korea has a very large project that was in the picture a while ago. In the lower left-hand corner (of the slide) is the first project we have supplied there. We are now providing the second project of comparable value of \$5 million. The Middle East is a very important market for us. We have a strong, dominant position in the Middle East because those companies make decisions based on value, not based on price. They look at the long-term reliability of the equipment and how important it is to their process. The Graham sales model and brand fit very well in the Middle East decision process.

We have an ejector system for the US refining market, which is a diesel application. You might be aware that gasoline consumption has declined in North America for the first time in quite some time. Refiners are moving toward diesel production, middle distillates, and there is some revamp work going on there. Exxon Mobil announced recently that they are going to invest about \$1 billion in three diesel projects for North American refineries. This is a project that was for TOTAL Petrochemical in Port Arthur. We also have in our backlog orders from Turkey for a combined cycle power plant, a \$2.6 million power generation project from General Electric, and an order from a turbo machinery OEM for a Chinese petrochemical project.

When we look at the markets today, the situation is concerning; but we view it as a short-term issue. The duration of the short-term is unclear to us, but the underlying fundamentals that drive demand for our products haven't changed. So, getting beyond the short downturn, we plan to come through on the other side as a stronger company, better positioned to take advantage of the opportunities coming from the energy market that will be driven from environmental regulations ongoing and throughout the world as regulations requiring cleaner transportation fuels, ultra-low sulfur diesel, and clean gasoline. Those applications require our products.

Feedstock diversification is a very important application where refiners are trying to lower the cost of their inputs. For an existing refinery, that provides a great deal of opportunity for our company as they have to revamp and replace existing ejector systems and add new process units to deal with the higher sulfur content of the poorer quality, less-expensive crude oil. Capacity creep, the process of trying to take an existing ground field site and produce more transportation fuels from that site, is another application for our systems. There are small investments that occur continually, regardless of where the market is, to expand the capacity of that refinery.

We see the long-term, underlying fundamentals not changing one bit. Demand growth is projected to increase 1% to 1.5% over the next 20 to 25 years. That is a significant opportunity for our company, just from the refining sector. There

is more than leg; it's just not capacity increase. Some environmental regulations and feedstock diversification drive demand for our products.

Now, for a quick overview of our financial highlights. There has been a very strong expansion cycle coming from the energy market over the last four years, in petrochemical and refining in particular. Our company has expanded its revenue from \$41 million in 2005, to our guidance of \$99 to \$103 million for fiscal year ending March 31, 2009. The compound annual growth rate has been just over 24% during this period of time. We've taken very strong advantage of the opportunities. We've been selective, but what has enabled us to grow our company during this period of time was a thoughtful process of changing our sales model, from 1998 through 2004, and an investment program to expand our capacity under our roofline through investments in new equipment for our facility, in automation, and in workflow, which enabled us to expand our capacity roughly 250% over this period of time without changing our physical plant.

We focused on productivity recognizing that there was a strong growth cycle, but in the past we've seen very abrupt down cycles come as well. So, while we grew, we were focused on the eventual downturn and driving, very urgently, productivity into our company. You can see our sales per employee have increased since 2004 from \$150 thousand per employee to over \$300 thousand per employee for the trailing 12 months. That speaks to the automation, the investment in new welding, machining, and burning equipment for our plant operations, addressing quality and addressing workflow.

Also, we've had a very disciplined approach to cash management, recognizing that there were things that we could do to improve our cash management in the business by connecting everyone across the business to a cash management strategy. Our inventory turnover has increased from roughly 4 to 5 times per year five years ago to between 10 and 12 for the trailing 12 months. To put that in perspective, when we were a \$40 million company, raw material inventory was about \$3 million. Today, we are a \$100-million company and raw material inventory is between \$1.5 and \$2 million, while the cost of raw materials are about two to three times more than they were four years ago. That speaks to the things that we've been able to do and the accomplishments we have made in improving our cash and inventory strategies. We've also addressed WIP; by reducing our WIP cycle we have helped our inventory turnover rate to double.

Expanding capacity, investing in automation, being a value provider to a market that makes decisions based on value, not based on price, our sales model, our operational model, and our aftermarket model have enabled us to, while we are growing, expand our gross margins appreciably from mid-teens in the 2004-2005 timeframe to eclipsing 40% during the last 12 months. Our guidance for the fiscal year ending March 31, 2009, is to be between 39% and 42% for the full-year gross margin. The consequence of this has been a very nice expansion in net income from a company that was a break-even company in 2005, lost money in 2004, to generating \$15 million of net income on \$86 million in sales last year, and for the trailing 12 months on \$99 million of sales, have a net income of \$18 million.

Going into a downturn, we feel our operating performance is superior to any other time in our history and our balance sheet is in great shape. We have \$45 million of cash and investments on our balance sheet, we have no long-term debt,

our pension assets are in good shape. Financially, going into a downturn, we are a stronger company than we have been in the past. We are going to approach this downturn as an opportunity to strengthen our company, to come through the downturn on the other side a different company, a stronger company, a company able to continue to grow, be more diversified, and have a stronger revenue and net income base.

As I mentioned, we placed a priority on cash management, connecting the sales process, the engineering process, procurement operations, and collections to an initiative to improve our cash conversion cycle. While the business grew 250% over the last four or five years, we've lowered our cash conversion cycle from over 120 days in 2004/2005 to under 40 days today. We are equally as proud of that as we have been of our profit performance. We believe our cash management strategies will stick with the company during the downturn.

Strategy and outlook. We've seen a very dramatic shift in the cycle, a step change if you will, which manifested itself in our quarter ending December 31, 2008. We've seen the backlog drop from about \$75 million to \$52 million, while the trailing 12-month booking rate has fallen from \$107 million to \$88 million. We've been here before; we are a company of 73 years of history selling into the energy market. Thinking back over the last four decades, we've seen this four other times, including this time. One with the late 1990s, a second one was the mid-1980s, and the third one was the mid-1970s. We are more prepared this time through the thoughtful process we applied while we grew the strategies to improve cash management, improve operating efficiency, to be prepared for the downturn. While we were growing, we had our eye on the eventual downturn. That's not to say we saw it coming; but we knew it would occur at some point in time, and we wanted to be ready for it.

This slide gives you a sense for a hypothetical scenario. As I mentioned, there have been three other downturns that were dramatic. In each case, from the peak to the year after the peak, revenue dropped by 30 to 35%. For a hypothetical case of a 35% reduction in top line from our current level of revenue, in the past we were a business that would break-even or be in a loss position. We believe that with what we've done with our operating efficiencies, with the way our company is being operated today, we will remain profitable even in the face of a 35% reduction in top line.

The past cycle peak for gross margin was in 1998 when gross margin peaked at 31%. During this cycle we have peaked at about 40%. Operating margin in 1998 was just under 10%; operating margin currently is about 23%. In the face of a 35% reduction in top line, we believe operating margin will be in a range of 8% and gross margin between 28% and 31%. We are a different company.

Our strategy for long-term growth. While we were growing the business over the last four or five years, there are two facets to our business. The very large refining projects and the large petrochemical projects is one part. But there is also a basic business that is much smaller in size with many more transactions of lower dollar amounts. We had strategies to increase the level of less cyclical sales or smaller product sales. We've been able to increase that by 50% over the four-year period and gross profit from those sales is up by 75%. So, our base of business is higher than it was in the past.

We've also focused on geographic diversification. We've established an office in Suzhou, China, a sales and marketing office, not bricks-and-mortar, that gains us access to the opportunities coming from China. China will continue to invest in its refining resources and its petrochemical resources, and we are in a position to take advantage of that. We are also focused on aftermarket. Our aftermarket revenue has been expanded from around \$7 to \$8 million per year to \$10 to \$12 million per year, and the margin potential in aftermarket revenue is much higher than new equipment sales. We are also selling into a broader array of markets: coal-to-liquids, gas-to-liquids, ethanol, bio-diesel, industrial gases, along with our core markets of refining, petrochemical, and power generation.

As I mentioned, we will continue to drive operational performance improvements across our business. We saw a very dramatic improvement in our financial performance because of these initiatives in the last several years and there is more that we can and will do. With the strength of our balance sheet and the ongoing operating cash flow we expect from the business, even during the downturn, we think this is the time to look carefully at acquisitions. We feel the valuations should be coming down over the next several quarters, and we will look for opportunities to expand our products or expand the markets that we are selling into via acquisitions. We will look for engineered-to-order products that complement our brand, that suit the markets that we are in or adjacent markets, and provide geographic expansion. We are not looking for businesses that we would turn around, but those that have a strong management team intent on staying and can diversify our product mix.

This slide gives you a sense for what we are seeing in the potential bookings pipeline. The bookings pipeline hasn't changed; it's been very strong. Our sales and application engineering personnel have remained busy over the last three or four years. We haven't seen that changing. What has changed, though, is when orders are being placed. We are seeing our customers move to the sidelines and let the supply chain cool down. They are expecting costs for their projects to come down 10%, 15%, or 20% by moving to the sidelines for 6 months, 12 months, or 18 months. The proposal work, the concept work, the budgetary work that we are involved in is extensive and hasn't changed.

We see work coming from the US for a lube oil project; China has three projects expected to proceed in calendar year 2009 for new refineries. PetroChina and Sinopec continue to invest in new refining capacity; a Middle East refining project for lube oil fractionation should be placed over the next couple of months, as well as fertilizer projects, ethylene, and petrochemical projects in India. Aramaco's joint ventures with ConocoPhillips or TOTAL is an area where they've said they are going to pull back to watch for the next six to 12 months before reengaging in the market because they expect their costs to build those new refineries to come down by 10, 15%, even 20%.

We see organic growth potential in Asia and in South America for our products. We do have a presence there now, but we believe we can capitalize on the growth that will be coming over the next several years from Asia and South America. We have a strong brand in the Middle East; there will be growth in the Middle East for refining and petrochemical projects. Organic growth is still available to us, even though we've grown two-and-a-half times over the last four or five years. Also

with the strength of our balance sheet and our strong operating cash flow, even through the down cycle, we can look at projects and be careful about adding new products and new businesses via an acquisition.

That's a very quick overview of the Graham story, which we think has been a great story over the last four or five years. And with that, I will be happy to answer to whatever questions you may have.

Q&A

Question: (Referring to the hypothetical downturn slide showing a 35% decline in revenue.)

Jim Lines: That was a hypothetical, that's not our guidance, we haven't given guidance. It's a very difficult time. I'm not being evasive, but to project at this point in time with the lack of clarity, and the way the markets froze in November and December, it's very difficult for us to offer any type of guidance that will be reliable. So, that's a hypothetical case looking back historically at what happened the three other times where revenue had declined 35%, It's not to say history will repeat itself; but it's the way to look at our business in the rearview mirror. I haven't answered your question, but it's difficult right now. Hopefully by the next conference call, which should be the end of May we will be in a better position to provide that guidance.

Question: How much visibility do you have in your business.

Jim Lines: Well, on one hand we have \$52 million of orders in our backlog, of which 90% is projected to convert to revenue over the next 12 months. Our potential bookings pipeline is pretty clear to us for 6, 12, 18 months in terms of the projects that are available. What's been unclear to us over the last six to nine months is when orders will be placed. That's more difficult to predict. But the demand for our products still appears strong looking out over the longer horizon, not just next quarter or the quarter after next. So, we feel we have a great pipeline for visibility in upcoming projects and we have a backlog that typically converts 90% over 12 months. Backlog normally represents 60% to 75% of sales for our coming 12 months.

Question: I'm probably relatively optimistic about a rebound, but when things really do fall apart, isn't this what we always say, "Oh they are just delaying it," "they are going to wait and see if your costs are going to go down over the next six to 12 months," and then those delays ultimately become cancellations and become business disruptors? What will give you the confidence that they are just delays and not just the next wave of bad news?

Jim Lines: Well, thinking of the sequence of way the projects go, and we are involved in all four stages of the sales process, in the first three stages no money is being spent. What we look for first as the signal that the business will be coming to Graham will be when the contractor has been awarded the project, when Fluor, Jacobs, Foster Wheeler or an Asian contractor has been awarded the EPC project or, before that, when a process like the Sorrel has been awarded the

FEED package to do the detailed engineering design for the facility. So, the first phase is concept, and we are typically involved in the concept, doing design options, capital operating cost trade-offs, when nothing is being spent. That could be 12 to 18 months before equipment will be bought. Then they will bring in a process licensor to do the FEED package. That could be a Foster Wheeler; that could be a Technic, companies like that. Again, no money is being bought, but they are doing the detailed analysis, the detailed engineering for the facility. Working with a company like Graham to look at the design options for our type of equipment is stage two. That could be 6 to 12 months before the equipment will be bought. After that there is the EPC bid stage where the global contractors are bidding the EPC project. The barometer we would look for is backlog of the EPC contractors. Once they've won the order that's a clear indication that it should be a green light going forward.

So, we look at the backlogs of Fluor, Foster Wheeler, Shaw Group, Jacobs, Technic, Toyo, JGC, Toyota, and GS Engineering in Korea, they typically win the majority of the work. As their backlogs increase that's a clear barometer that equipment will be ordered going forward.

Question: Along that line, do you get a cash down payment equal of 30% to 40% on the orders or are you just doing it on work in progress?

Jim Lines: That would be great if we get it with the order. Unfortunately, we do not. We have, for the large projects, a progress payment schedule, typically tied to a milestone. We may be able to get 5% or 10% when the order is placed, within 30 to 45 days after the order is placed; but typically we have a deliverable, such as when our engineering drawings are delivered, we might receive 10 or 15% of the contract value as payment, and that would arrive roughly 12 to 14 months after we have the order. Then we tie another payment to receive the major materials.

Question: How big is the ejector market, in a hot year, like last year, how big is the market globally?

Jim Lines: We would view the ejector market as being about a \$250 million to \$300 million market.

Question: And whom do you compete against with that?

Jim Lines: In the international market, we compete against two German companies. One is a company in the GEA Group called GEA Jet Pump. The others are private companies: Korting Hannover out of Germany and BOC Edwards in the UK.

Question: Just taking a \$2 million project, labor is 5%?

Jim Lines: That's fair. Direct labor is 5%.

Question: And then, how much do you buy outside on the raw materials part?

Jim Lines: Well, raw materials typically represent between 60% and 65% of Cost of Goods Sold (COGS) and direct labor would be somewhere around 8% to 10% of COGS.

Question: The model you gave on \$65 million, you were making money because your SG&A was \$14 million. How much flexibility is in that, \$1 million?

Jim Lines: That's fair. During this downturn, we wanted to stay strong and close to our customers. We've added to our sales force during the downturn, but we have flexibility there if we are trying to manage for the short-term rather than the long-term.

Question: Who's the Berkeley family?

Jim Lines: One of the co-founders was Fred Berkeley. His son, Duncan Berkeley, ran our company from 1968 to 1998. Duncan Berkeley's wife, Helen Berkeley, is one of our Board members. She has 5-ish percent of our stock I think. Any other questions? Well, thank you for your time.