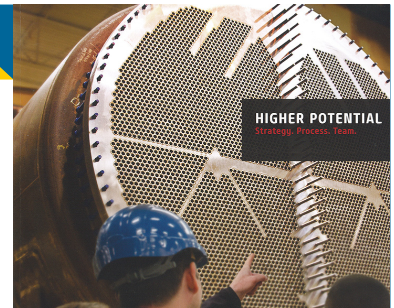
GRAHAM
ENGINEERING ANSWERS



An interview with:

Chris Johnston

DIRECTOR BUSINESS DEVELOPMENT
GRAHAM CORPORATION

Can you tell us about yourself and background?

Being the Director of Business Development at Graham Corporation, I am responsible for corporate development and new market expansion. Having worked for the federal government in the past, as well as in nonprofit and private sectors, I gained a wide range of experience that is able to be put into practice in my current role.

Fordham University is where I received an MS in International Economics. In 2010 and most recently reappointed for another four years in 2019, I am honored to serve the US Secretary of Commerce representing Western New York's regional interest in promoting the benefits of international trade on the US Department of Commerce District Export Council (New York). Buffalo, NY is where I call home and enjoy spending time with my family, performing community service, and in my spare time, cooking.

How would you describe Graham's M&A strategy and how it fits with the Company's growth strategy?

At its core, it begins with our top priorities to grow our business and improve financial results. We start with what we are strategically trying to solve and then test it, or verify, that creating and improving shareholder value can be realized. Creating and maximizing shareholder value is of the utmost importance to Graham, and using our strong balance sheet to grow organically and through acquisition is a key element in fulfilling our strategy of realizing this value.

We are targeting acquisitions that will provide growth and dampen the cyclicality that impacts us in the energy markets. We are looking to diversify our customer mix, but remain true to our values. For example, expanding revenue opportunities within our growing naval nuclear propulsion segment is of compelling interest to us. Simply stated, that is additional products within existing markets.

Another one of our priorities is increasing the level of predictable revenue in our historic energy markets, where we appear to face increasing uncertainty. Therefore, in addition to naval work that is fairly predictable, our strategy is around aftermarket and the installed base, or in entering a new market uncorrelated to energy.

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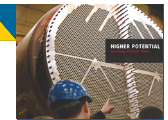

Chris Johnston *interview cont'd.*

How do you generate opportunities and expand the funnel for companies to assess?

Graham uses multiple methods to explore assessment opportunities of potential companies. We are engaged with a number of boutique investment banking firms that have met with Graham management, understand what we are seeking and create deal flow. Secondly, we participate in a number of industry conferences where suppliers, like Graham, attend. We network, develop connections and begin nurturing relationships. An outreach program is also in place that targets companies in key sectors or that have ideal product lines. Graham also offers marketing material that confidently promotes the company as a strategic buyer with particular capabilities. In addition, we may be contacted by bankers who have a seller that views Graham to be an appropriate buyer for their business.

We believe the cultivation of relationships with owners, perhaps not immediately thinking of selling, will garner the best deals.

Tell me a little more about the company profiles you are looking at as acquisition opportunities.

Interestingly, we first consider what we can do for the business we are targeting. For instance, can we help them grow? Can our operational excellence complement theirs to unlock uncaptured margin? Is it possible to create greater financial returns through opportunity and pricing management? We believe this opens a potential seller's mind to the possibilities with Graham as a partner. We then turn and look at how that reshapes our financial results and earnings power.

From a revenue perspective, Graham is looking at companies generally within the $20-$60 million range, with our primary focus on Defense, US Navy or aftermarket in the energy markets.

It is important to us the prospective companies have a strong management team that wants to remain after the acquisition. Graham does not have the management bandwidth to insert resources into the daily operations of a business. We are not interested in a turnaround or a company where the management team is looking to cash-out of the business and leave.

What are your financial criteria?

Our financial criterion for a deal involves more than just accretive to earnings. Given the low returns on cash and low cost of debt, we think accretion is too low a bar for return on capital. Our focus is to get acquisition financial results similar to a capital project - a cash return that is similar to an equity-type return; something in the low to mid-teens from an IRR standpoint. If they can do that, and manage their balance sheet, as we believe we can manage our balance sheet, then the accretion happens. Many companies do the opposite. They look for immediate accretion alone, and then they look at the deal four or five years later and ask, "What happened to the cash flow? What happened to the balance sheet?" They may have gotten accretive earnings from a book standpoint, but from a cash standpoint, it is not good.

Graham looks for the stronger financial return, and that is hard to do if you overpay for an acquisition. Often, if involved in an auction situation, you can get into a bidding war and overpay. Our strategy does not include doing either of those – participating in an auction or overpaying.

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Chris Johnston *interview cont'd.*

Given the high-bar you have set, how do you go about finding acquisition opportunities?

Our approach is to look at the markets and product areas Graham is interested in. We then identify companies that fit our mold. These are generally private companies who we reach out to directly and then begin establishing relationships. This is a critical component of our identification and cultivation strategy. Our process is to build and nurture that relationship, to build the trust needed to make a deal possible. This takes time - months, quarters, even years, but we believe the outcome has a higher probability of creating deal value.

The process involves patience. While not every opportunity works out in terms of an acquisition, we do find sometimes there are shared business opportunities between Graham and our targets which translate into alliances, or business opportunities for both companies, and ultimately build trust and stronger working relationships. There may not be a current interest in selling, however, down the road their situation may change and Graham may benefit because of the business relationship we cultivated.

Does this make the process longer?

The relationship is the important part of our process. It may elongate the timeline, but we believe it makes for a smarter, better, more successful acquisition. Graham has been implementing this process for some time and has built many mature relationships with companies in our target markets. If we can find the right business to ultimately acquire, and at a price we think is fair, and meets the other criteria discussed, then it would be expected to be a good acquisition. Graham is not looking for multiple acquisitions; on the contrary, we are looking for one really good one.

What end markets are you focused on?

Historically, refining and petrochemical energy markets make up three-quarters of Graham's business, which can be quite cyclical in nature. These are great markets when you are in the up part of the cycle, however, when the down cycle occurs the ride can be rough. Graham has lived through a couple of down cycles in the past decade. We are looking for other, more predictable revenue to balance the cyclicality, which can also add customers and solution offerings.

Graham is focusing on expanding our US Navy business, which we have organically grown from 5% to now 25% of our revenue over the past decade. Our efforts are directed at growing this segment even further. Navy work presents larger, long-lived projects that are not in sync with energy markets, and while these orders are typically large and sometimes slower to develop, once the project is in-house, they provide an annuity-like revenue and profit stream. This allows us to better plan the operations and fabrication side of our business, and ultimately the revenue. This also enables Graham to control the profit side more efficiently than typically can be accomplished with the capital-driven refining and petrochem business.

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Chris Johnston *interview cont'd.*

Are there any markets you might consider that you do not already sell to?

We have closely looked at other markets where Graham products fit well. These markets are typically where customers are looking for precision and/or customization, and are willing to pay for it. They are not buyers who believe that "good, is good enough." Nuclear submarines and aircraft carriers are precision engineered kind of customers. Consequently, the Graham focus is currently on the US Navy projects, along with the aftermarket in refining and petrochemicals. These markets are not as volatile as the capital side of refining and petrochemicals.

What does your current funnel look like?

The Graham funnel is deeper than it has been in a while. Over that past few years, our team has been focused on identifying potential targets, nurturing relationships and taking companies through our process. We have a healthy mix of mature relationship companies (3-4 years) and newer ones that we have established as a result of our direct targeting, involvement in trade associations and working with key leaders in the industry. Graham has a pretty good array of companies, primarily in the US Navy space, and also in the aftermarket of the refining and petrochemical market.

We have a nice funnel of opportunities, and are looking to find a company that makes sense, one that we want to buy, and they want to sell, one that benefits both of us.

When do you think you might make a deal? Can you see a near term deal, say in the next 12 to 18 months?

We have progressed quite far down the path with a couple of companies; in fact, a majority of the way. Graham chose to peel off these opportunities because, as we completed our due diligence, we found that either the companies did not have the means to execute to their forecast, or the business we thought was there initially, was not as robust as Graham had been led to believe.

It is possible that Graham could commit to a deal in the next 12-18 months, as at any point in time we do have a number of companies in our opportunity funnel. This is how our process and funnel works. My answer would have been similar two to three years ago. The fact that nothing has happened in M&A for us is not a function of lack of activity or lack of volume in the funnel. It is just a matter of finding the right fit at the right time for our company and business.

Chris Johnston *interview cont'd.*

Have you had deals that were nurtured, but fell apart in the end? Why did they not get to the finish line?

We have worked a number of deals that ended up breaking down. The nurturing process and getting to observe other management teams is important. It is incredibly valuable. A key tenet for Graham to evaluate is whether their processes are under control, can management forecast and achieve predicted results. When we observe a problem in these vital areas, we dig in, ask tough questions and, consequently, negotiations can begin to unwind. The starting part, of course, is management's plan. When we see that plan unraveling without a clear event and action plan to get back on track, the antenna goes up and the prospective seller begins to feel pressure from our side. The ultimate breaking apart stems from a valuation gap or, quite honestly, the talent at that business cannot pull off their own plan. While it can seem frustrating and the time and resources spent fruitless, it is a positive outcome to have before making the mistake of buying a business. It is part of the process, and I view it part of our success in due diligence to identify such a critical issue.

The Graham process is disciplined and to our credit we have not lost discipline due to simply wanting to accomplish a deal. There is clear conviction to put our balance sheet to work, nonetheless, management and our board do not break discipline.

Would you consider carving out a piece of a business, if you could not find an entire company that makes sense for Graham?

There are occasionally public or private companies that will sell, or divest, a piece of their business. We do see some upcoming divestiture opportunities, as companies are trying to maximize cash flow right now as a result of market conditions. We could even consider a scenario where Graham would buy a potential target and sell off a piece after the deal. That is not something we have done before, but is in the realm of possibility. We keep our funnel open to all possibilities, and allow the process to lead us to the best decision for the company.

What do you think the current economic environment has done to M&A opportunities, particularly the types of companies you are looking at?

Some of the companies in our funnel may have been severely impacted by the current economic conditions, although the ones we look at tend to work more closely with the US Navy and its supply base. These companies have been less impacted because they are essential businesses and have been able to continue working throughout the pandemic. We have added some new relationships recently, however, the communications furthest along are those initiated two and three years ago, well before COVID. By having built trust with those companies, it has allowed us to keep conversations ongoing and learn more about how the pandemic has impacted their businesses.

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Chris Johnston *interview cont'd.*

Why do an acquisition when you have had the cash on hand for so long? Why not buy back stock?

Graham views a buy back as a short term fix and not as true value creation. We want to use the cash like we were investing in capital equipment; use it to grow our business. That is how we are thinking about the cash on our balance sheet (and our debt capacity if need be). Graham wants to make the most of the capabilities it has to offer and that includes expanding them in new markets, products and project opportunities and with new customers. We want to make Graham an even better company in the future.

Another positive reason for not having a buy back is that during past cycle down turns, we have had to lay workers off as the business declined. If we could add more business from an acquisition that is not in sync with the refining and petrochemicals market, than we would be able to shift work to the other end markets and retain our employees. This would allow us to take advantage of the opportunities that come with the recovery and grow faster than our competitors.

What has held you back from making a deal?

I would not say we are limited, but rather, we are patient in finding the right match with a seller who wants to sell, is a good fit for Graham and builds long term value creation. The reality is that if we execute a good strategic acquisition, our investors will be happy with the return. The thing Graham keeps as a main focal point is, we want that happiness to continue.

That great long-term fit is what we are striving to accomplish. We do not want to be a hero on Day 1 and then regret it a few years later. The search will continue, the discipline we have in place will prevail and Graham is confident of finding that perfect fit.