Operator: Greetings, and welcome to the Graham Corporation Second Quarter Fiscal Year 2011 Quarterly Results Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Ms. Deborah Pawlowski, IR for Graham Corporation. Thank you, Ms. Pawlowski, you may now begin.

Deborah Pawlowski: Good morning, everyone. We appreciate your joining us today on Graham's Fiscal 2011 Second Quarter Financial Results Call. On the call I have with me today Jim Lines, President and CEO of the company, and Jeff Glajch, Chief Financial Officer. Jim and Jeff will be reviewing the results of the quarter, and also provide a review of the company's strategy and outlook. On our Web site at www.graham-mfg.com, you will find both the press release as well as supplemental slides that are posted there, which Jim and Jeff will be referring to during the formal part of their discussion.

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 Web site or at sec.gov. So with that, let me turn it over to Jim to begin the discussion.

Jim Lines: Thank you, Debbie, and good morning, everyone. As a reminder, Jeff and I will refer to slides posted on our Web site during our discussion this morning.

Beginning on slide three, as you can see, revenue in the second quarter was $15.7 million. We believe the second quarter represented the end of a four-quarter in duration steep contraction in revenue. While we anticipate the bottom is behind us, recovery in our markets is expected to be gradual. There was 17% sequential revenue growth comparing the second with the first quarter. We expect revenue will continue to expand in each quarter for the remainder of the year. Our full-year revenue guidance is unchanged at $65 to $72 million.

Turning to slide four, international markets continue to drive our business. While there are opportunities in domestic markets, Asia, the Middle East and South America are providing a greater number of opportunities. Revenue in the second quarter was driven by orders that are for Columbian, Venezuelan, and Mexican refineries. Asian market segments were more diverse, with revenue coming from orders for fertilizer, ethylene, refining and power generation projects. We also are converting now backlog comprised of a number of different orders for Saudi Arabian refinery projects. Sales to domestic markets included refinery, fertilizer, and power generation; primarily renewable energy markets.

Turning to slide five, we had a couple light quarters for new orders. Second quarter new orders were $10.5 million, bringing first half bookings to $18.6 million. The second quarter had 30% sequential growth versus the first quarter, but $10.5 million is still a low level of bookings in a quarter. Our exceptionally strong and high backlog level is a solid foundation to build upon and to soften the effect of the low level of new orders during the past two quarters. We are projecting 60% to 70% of backlog converts into revenue across the next 12 months.

Further to my comments about the importance of international markets, first half bookings had 22% for South American markets, primarily for refining applications; 10% were Middle East markets, again, principally refining services; 10% were mainly to our refinery and petrochemical markets in Asia; and, 10% for Canadian refinery and renewable energy markets. In total, approximately 60% of new orders were for international markets in the quarter.

Turning to slide six, the company continued to operate well considering the steep decline in revenue stemming from the global downturn. Our managers and all employees worked hard to ensure customer commitments were maintained, and we continued to invest to become a faster company, and always seek to improve our processes. I commend our employees on their accomplishments and for staying the course through a tough period.

Costs were addressed quickly when our markets changed. But more importantly, the benefits of the actions taken during the past four years were never more evident than during the last four quarters. While controlling our markets is impossible, we did demonstrate that we could influence what is within our control to operate differently during this downturn. Specifically, productivity is considerably higher today, up about 10% to 12% from four years ago.

Rework, as a percent of production hours, is at about 60% of where it has historically had been. Lead times continue to shorten. We are becoming a faster company. And workforce flexibility and cross-training has helped tremendously. Having now passed the midpoint for the year, we are narrowing our gross margin guidance to 28% to 30% for the full year, with SG&A forecasted to be between $11.8 and $12.3 million.

With that, let me turn it over to Jeff for greater detail on the quarter.

Jeff Glajch: Thank you, Jim, and good morning, everyone. We are reiterating our previous revenue guidance for fiscal 2011 of $65 to $72 million. For the full year, sales are expected to increase 5% to 15% compared with last year. We expect growth in the second half of the year compared with the first half of the year, with sequential growth of approximately 25% to 50%.

In the second quarter, the trend toward higher international revenue continued, with 52% of the total revenue coming from outside the US. The split by region in the international arena does fluctuate based on specific project timing. As Jim mentioned earlier, Latin America and South America, as well as Asia, were strong regions this past quarter.

On the next slide, you will see our backlog continues very strong at over $83 million. Although it is down 12% from the record high of March 31st, it is still 10% above the previous record achieved at the peak of the last cycle.

The US nuclear carrier project is a big component of our backlog. We began limited production this past quarter, a little earlier than planned. While we expect to continue work on this project in the second half of fiscal 2011, we will recognize only a small amount of revenue for the project this fiscal year (FY 2011). We do, however, expect to see a more meaningful revenue recognition for the project next year (FY 2012).

From our backlog, 60% to 70% of it will convert to sales, we believe, in the next 12 months. This is less than the normal 85% to 90% that we see, and the primary difference is due to the long conversion time on the Navy project.

As of the end of June—we had three projects totaling $5.4 million on hold. One of the projects, which was $3.3 million in value, was released to production in the second quarter. The remaining two projects, which total just over $2.1 million, continue to be on hold (at September 30, 2010), but we do believe that they will be released hopefully over the next couple of quarters. However, we don't believe they will contribute any revenue in fiscal 2011.

Looking at orders, we are continuing to see the trend where more orders are coming from the international arena; a trend we have seen for most of the last year and a half.

Taking a look at Q2 performance, gross profit and operating profit were both down slightly versus last year. If you recall, in last year's second quarter, we were still producing orders which came in-house during the previous market up cycle, and were at a better pricing level.

For SG&A, we were in line with our expectations in the quarter. As you can see, our SG&A has leveled off over the past year subsequent to the restructuring which occurred in late fiscal 2009, and then again early in fiscal 2010.

Despite the cost reductions we made 12 and 18 months ago, we continue to invest in sales and engineering capacity, and believe that this has helped us not only maintain market share, but actually gain share over the past 12 to 18 months. Thinking about costs, as we have begun to see revenue growth, we are judiciously hiring both in production and in engineering.

Looking at our cash position on the next slide, you can see we continue to have a good cash stockpile to utilize for investment, specifically acquisition activity. Cash at the end of September was $70.8 million, and as you know, we have no bank debt.

We continue to generate cash from operations. However, the cash generated is being offset as we begin to reduce the excess customer deposits that came in-house in late fiscal 2010. We reduced the customer deposit level by approximately $3 million in the second quarter. At this point, we believe we have customer deposits $10 million to $12 million above its normal level, and expect over the next four to six quarters to continue to see this excess reduced.

Another cash usage area is capital spending. We continue to expect to spend $2.8 million to $3.2 million in capital this year, half of which is to support the Navy project. To date, we have spent approximately $700,000 in total capital, but I can assure you, given the production, the construction activity at our plant today, capital spending has picked up in the third quarter.

With our free cash, we continue to be very focused on our acquisition program. We are pleased that we are continuing to be successful in identifying strong acquisition candidates with extremely capable management teams in the markets that we have targeted.

Also in the second quarter, we repurchased 48,000 shares of stock at a cost of just over $700,000. To date in our repurchase program, we have bought 351,000 shares.

Our next slide is our outlook for the rest of the year. As mentioned earlier, we expect to see sales growth from the first half to the second half of the year, and are reiterating revenue target of 65 million to $72 million. On a quarterly basis, we saw growth in revenue from Q1 to Q2 of this year. We expect sequential growth from Q2 to Q3, and then further growth from Q3 to Q4.

Normally when we see revenue growth, we also see improvements in gross margin. However, in the short-term, we expect gross margins to decrease. The improvement generally seen by increasing utilization is fully offset and then some by pricing pressures, which were incurred 9 to 15 months ago during the depth of the downturn. Project margins won during that time period were very competitive, as all competitors were chasing very few projects.

We also had a number of lower margin projects move out of Q2 and into Q3. We were able to backfill capacity by moving a few higher margin projects into Q2, however, the net result of doing that was a stronger margin than expected in Q2, and we will see the impact of this resulting in weaker margins in Q3. We do expect margins in Q4 to be better than Q3, however, not to the level that we saw in the first half of the year. We do continue to believe that when markets fully recover at the next market peak, we expect to see margins in the mid to upper 30% range.

Finally, on the final slide, we think it is important to take a look back at our business, and a look at how we've changed the structure of our business. This slide looks to business and EBITDA performance during the previous cycle and the most recent cycle. You'll see in the previous cycle, EBITDA margins peaked at 11.1% in 1998, with a revenue number of just over $50 million. And as the markets began to decline, our EBITDA margins dropped into the low single digits. Looking at our current performance, EBITDA margins well exceeded that 11% range. In fact, we're above 25% in fiscal years 2008 and 2009.

Just as important as the superior performance in the upper years in the top of the cycle was our performance during the bottom part of the cycle. As you can see in this last four-quarter period, in the Q2 trailing 12-month timeframe our EBITDA margins were 13.8%, which was actually above the peak EBITDA margins of the last cycle. We believe that restructuring our business over the last many years has put us in a different position today than we have been in previous cycles.

The reconciliation of how EBITDA was calculated is attached as a supplemental slide for those of you who would like to take a look at that. With that, I would like to thank you for your interest in Graham and your time today, and would ask the operator to open the line for questions.

Operator: Thank you. We will now be conducting a question-and-answer session. Our first question comes from the line of Rick Hoss of ROTH Capital Partners.

Rick Hoss: Jim, reading through the press release, it seems like the booking commentary is a little bit more upbeat than it has been in the last, I don't know, say, three quarters. Am I reading this correctly?

Jim Lines: Well, we continue, Rick, to see a very positive number of projects in our pipeline, geographically and end-use market diverse, which is good; so refining, alternative energy, petrochemical, geothermal, all areas where we have strength, and the pipeline continues to expand. While having soft bookings in Q1 and Q2, we don't think the underlying demand drivers have changed. Again, we talked in the past about it being a timing issue as to when orders are won. We continue to feel bullish about the outlook based on the proposal work and the sales work that we're doing, and we do remain positive. But predicting the timing for when orders will be placed has been very, very difficult the last many quarters.

Rick Hoss: Does it seem like it's closer now, or noticeably closer than, say, the last two calls that we've had?

Jim Lines: It's hard to judge. I felt it was close one quarter ago; I thought it was close today. But until we get to the negotiating table, it's really hard to predict. And even the negotiations tend to be more extended than normal. When I say normal, going back a couple of years. In general, qualitatively, we're very optimistic about the near-term, but predicting the timing of translating the pipeline into bookings is very difficult.

Rick Hoss: That's understandable. Now, for the third quarter and the fourth quarter of '11, you've discussed the gross margin implications of the competitive environment. Are you seeing competition continue on, and do you expect to see this below 30% type of gross margin in the projects that you're bidding on currently?

Jim Lines: Yes, that may very well be possible with the bookings over the next quarter or two. The driver of that will be a number of opportunities that come to closure at a given point in time. When there are very few, the results is a hyper-competitive situation, which is what we saw 9 to 15 months ago, we expect it to slacken a bit in terms of margin pressure. But until we see the pipeline move toward procurement, we're expecting very competitive pricing from our Asian and European competitors, just as we have seen.

Rick Hoss: Looking at this productivity slide, slide 13, it's a pretty impressive difference between the two cycles. Can you give examples of the productivity initiatives that you've implemented over the last, say, 12 months? And are these largely complete, or would there be enough additional projects that would increase this further, all else being equal—in other words, sales being steady?

Jim Lines: By no means do we think we're done with our attention on improving our business and its operating performance. We have made substantial strides and investment over the last two or three years. You could add this with our capital plan, with our continuous improvement efforts, with our IT initiatives to become a faster, more efficient company. If I were to give an indication of where we are in the race, we're probably a little bit beyond the midpoint. There's still a lot that we can do. There's a lot that we're going to do.

And we did this with an intent, of course, to serve our customers better. But we also recognized when we were in the middle of the last cycle, we would be facing more price pressure; more margin pressure. And our response to that had to be business improvement. So we focused on this a couple of years in advance before it actually materialized, and again, the benefit of it is evident the last four quarters. So we're true to this. We believe in it and we're not through. And we'll never be done improving our business.

Rick Hoss: Jeff, one for you. How do we look at an out-year type of a tax rate; 32-ish, is that fair?

Jeff Glajch: Yes. I think, Rick, kind of 32%, 33% is probably a fair view looking forward.

Operator: Our next question comes from the line of George Walsh with Gilford Securities.

George Walsh: Jim, I'd also like to talk just a little bit on that slide number 13. It really is a testament, as you said, to the changes that have been brought about in the company in being able to better exploit the cycles. I wonder if you could talk about the difference in the type of cycles that there may have been, in pricing and the type of business. And I'm really bringing this up in reference to how you see the next cycle coming in terms of whether it's more international versus domestic, in addition to the improved efficiencies that you've brought to the business?

Jim Lines: Yes, there's a lot, of course, that went in to the cycle-over-cycle improvement. Much of our strategy, and George, you were with us in 2006 and 2007 when we had throughput issues; we were constrained on capacity. We really centered our sights around how do we gain incremental throughput, recognizing that the incremental revenue and therefore the incremental profit is substantial in our business for the amount of leverage that we have. But we focused on gaining capacity across the company to execute more orders. And that began to, of course, improve the dropdown to the bottom line; improve the EBITDA margin.

But we did have a very strong cycle in this last cycle. The weighing was largely domestic. About 60% of the revenue was for domestic markets, which have a better transactional cost basis and a better margin potential. But we knew that would be short-lived, and we focused on, again, improving our business to position ourselves to be cost competitive with acceptable operating performance in an environment that was not like this past operating cycle.

We don't believe going forward—going into this next cycle it will be as heavily dependent upon the domestic markets. It will have a greater weighting toward international markets; as we've mentioned, Asia and Middle East, South America. And the improvements we've put in, and the improvements that we plan to still put into the business, will counterbalance it and hopefully offset that margin pressure that we expect to face in terms of competitive pricing.

George Walsh: Can you elaborate a bit on your acquisition progress, and what—how close you may be, or what kind of size and things that we might see?

Jeff Glajch: As we've talked on the last couple of calls, we continue to meet with potential candidates, and we have, certainly, I'd say in the past six months or so, come into a number of good opportunities. And at any point in time, we're talking to a couple of fairly serious candidates, and we're hoping that something moves forward in the near future. But our premise upfront was making sure we found the right company, the right markets, and do it at the right price. So until we've got that all nailed down, we won't necessarily close anything. But that being said, we certainly at any point in time, have a couple of what I'll call serious or hot candidates going on.

George Walsh: Is the likelihood these deals would be cash, all cash, or would they be cash and stock, or stock?

Jeff Glajch: I would assume they would be all cash. There certainly could be a scenario where it could be cash and a little bit of stock. But our intent is not to dilute our existing shareholders, so our going-in plan is all cash.

Operator: Our next question comes from the line of Dick Ryan of Dougherty.

Dick Ryan: Jeff, I think you talked about one contract being released that was on hold, and there are two still on hold. Is there any commonality between those contracts, whether it's in a specific industry segment or geographic region at all?

Jeff Glajch: No, Dick, there really is not, and we're pretty optimistic that at least one of those will be released very soon, and hopefully the other one not too long in the future.

Dick Ryan: On your order activity, with the switch more towards international, can you give a sense of what the pipeline of opportunity looks like, whether that's a qualitative or quantitative assessment? And are there challenges coming in to your bidding process with raw material prices?

Jim Lines: I'll take the second point first. We don't really see a lot of challenge with respect to raw materials. Clearly, we're seeing a run-up in the cost of copper. When we think of our material mix as a business, copper is a large percentage of our material purchases. But the process that we have around bidding, bid validity and then post-award, after we have an order, being able to secure volatile commodity pricing, we don't see much risk there. We think we can reflect in our bid prices the current cost of the commodity. So we've been able to manage that fairly well over the last few years.

When we look at the pipeline from an end-use market standpoint, Dick, a lot of the work that we're seeing is for refining applications. We have refining opportunities, and we spoke about this in the past, in the Middle East, in China, in South America. Also, which is nice, we've seen some early stage petrochemical work. We've won recently a few ethylene projects in Asia; one for India and one for Taiwan. There are other ethylene projects in our potential bookings pipeline. We see that as a precursor to the recovery of the petrochemical markets.

Also, we're seeing a fair amount of activity in the fertilizer area, and that's mostly international work. That's an area that we've been strong in over the years. That would be ammonia plants and urea fertilizer plants; very specialized technologies where there are fewer competitors for those applications. And in the in our home market in alternative energy, there's a large population of bids that we have for alternative energy in North America; biomass energy, waste to energy. And those are areas where Graham has had a reputation going back to the '80s in servicing that market.

Dick Ryan: To move some of those projects forward, does anything have to get further released and more definitive plans coming out of Washington for an energy program now?

Jim Lines: I think for the alternative energy opportunities in the North American market, they do pace at a relatively slow stride. There's a permitting process. There's a public debate process around it. It's a lengthy upfront cycle to get those projects started and to get some momentum going. I think the energy policy is fairly clear around renewables, and the subsidies in support of renewable energy. I think the rest is just the political environment or the administrative process of getting through the hurdles that have to be jumped over before equipment can be bought and the facility be started

Operator: Our next question comes from the line of Walter Lang with Avondale Partners.

Walter Lang: Thank you for taking my call, and congratulations on your continued progress in a challenging environment. And this is relative to last question as well, and you mentioned this in the first question. On the press release, the opportunity in renewable energy, could you provide more insight into that? Is it limited to North America? Is there an international opportunity? The first question you had mentioned geothermal, if I heard you correctly, and then you mentioned in the most recent question biomass energy and waste to energy. It would seem to me, intuitively, it's a limited opportunity relative to petrochemical, but simply could you provide more insight into that opportunity?

Jim Lines: When we look at renewable energy, our initial focus has been in the domestic market. But to be fair, there are opportunities globally for that. We see renewables being pushed in Asia as well. It's in Europe, where we don't have a very strong position, to be fair. But we see renewables as being global-oriented, but our initial focus, because of cost pressures in the local Asian markets, we feel a better probability of success in our home market.

For geothermal, that certainly has a very large international component to it, and a satisfactory domestic component to it. Internationally, we've been successful I guess it's the Ring of Fire in Southeast Asia, Indonesia, the Philippines. We have installations in those areas. We're seeing work coming from Central America. We haven't won that yet, but we've had some bid opportunities there. And then in North America for geothermal energy on the West Coast in the California area, we have a good install base there. We have a number of bid opportunities that we're in early stage bid work on for those projects.

Operator: Our next question comes from the line of Brian Rafn of Morgan Dempsey Capital Management.

Brian Rafn: A question for you on the Gerald R. Ford aircraft carrier, the new class replacing the Nimitz carriers. Are you guys seeing where the pressure that Gates is talking with DoD—are you seeing any ongoing pressures to cut costs relative to your deal with new partners?

Jim Lines: We haven't seen pressure with respect to the order that we have in-house on the CVN-79 carrier; the Gerald R. Ford carrier. We are aware of the cost pressures for the Department of Defense, the Navy program, and certainly everyone's sensitive to cost creep and driving down purchase prices. But for the order we have in backlog now, we haven't had any pressure on that.

Brian Rafn: Are there any incentives built into that to recover a lower cost?

Jim Lines: No.

Brian Rafn: Given the fact that this is the first carrier of this class, does your being a vendor on this (program), does that help you guys at all in winning business on the next carrier?

Jim Lines: The order that we won for CVN-79 is the second carrier in that class of carrier. We did the first carrier about five years ago. We did not win that project, but we actually won the order for the second carrier. We think success going forward with the Navy really stems from executing well on the contract, maintaining schedule, and of utmost importance is the quality of the fabrication of the product. And we think Graham executes extremely well and delivers a super product, and we will deliver a super product to the Navy that positions us well for future work.

At this point, we've had a very satisfactory interaction with the Navy. They've been very pleased with our first year of progress on the order, and we're trying to position our company to be a larger supplier to the Navy for their Naval Nuclear Propulsion Program.

Brian Rafn: Does that go beyond just specifically carriers into, you know, you're not building battleships anymore, but certainly cruisers and frigates?

Jim Lines: It does go beyond carriers. There are other vessels that this would apply to; submarine in particular. There's more work on the carriers as well that Graham could provide its products for, not just the order that we're on. So we see additional opportunities for carrier work, and we see different classes of vessels where we can provide our products as well.

Brian Rafn: If you look back over your past cycles, can you give us a sense, you know, in the conversion of the number of bid quotes to actually converting to an order booking—is it 10 to one, six to one, five to one? And as you get into a new up cycle, what are you seeing on bid quote activity versus what order bookings are?

Jim Lines: With our sales cycle, Brian, our bid cycle, we are normally involved very early in projects. And we want to be. We're involved sometimes 12, 18, 24 months before the equipment is going to be bought. And we do track what we call our raw capture ratio, which is the number of orders versus the raw bids that we did. That's not a clear indication of success, but that really hasn't changed a whole lot over the last 20 years or so that we've been looking at it, and it's fairly flat.

What we tend to look at is a real capture ratio, which is the wins versus the losses for those projects that actually went ahead. And as the projects begin to move through the pipeline, get toward purchasing, that's the real metric that we want to look at; how successful have we been in closing.

If I look back over the 12 to 15 months ago we were in at a tough economic period, we saw our real capture ratio go up. As we were aggressively focused on where the opportunities were, we had our sales team and our business positioned to win the orders, and I believe we took market share because of our strategy to be close to the customers through the downturn so we could identify where the pockets of business was and we could win it. We actually moved up our real capture ratio.

Brian Rafn: Can you talk and put a numeric—a quantitative number on what the raw capture was over the last 20 years?

Jim Lines: It varies by product. But to give you an average number, it's about one-in-eight to one-in-ten.

Brian Rafn: And then how has the real capture ratio from a quantitative standpoint changed or upgraded?

Jim Lines: I don't want to get into too many specifics, but it's somewhere between one-out-of-two to three-out-of-four.

Brian Rafn: Finally, you guys talked about— and I picked this up, correct me if I'm wrong. You talked about hiring engineers or hiring labor. What specifically?

Jeff Glajch: Yes, we did. As we're seeing our revenue expand, working through our backlog, we are in a position now where we are judiciously hiring both from the direct labor area as well as in our engineering group. We did make some reductions during the downturn when our revenue were at the bottom. More of the reductions are on the direct labor side as well as some of the support staff. As we're moving forward, we are essentially rehiring in the direct labor side, and continuing to enhance our engineering organization.

Brian Rafn: Would that be tens of individuals—certainly not hundreds?

Jeff Glajch: No, no, no. It's a relatively small number. It's a handful each quarter; a handful being three to five each quarter for the last quarter, and maybe a couple of quarters going forward.

Brian Rafn: If you guys would just talk a little bit about what kind of capitalized multiple assignments on EBITDA are you seeing in the M&A side? Are they coming down, and kind of where are they today?

Jeff Glajch: They are certainly better today than they were, say, 12 months ago. I would say 12 months ago people were looking at peak earnings of the past cycle and putting the multiples that were, in my view, out of range; nine, 10, 11, 12. We're certainly in a range now where we're kind of in a four to five to seven range. And I'm certainly much more enthusiastic, not only where the pricing is, but at the quality of the companies that we're able to talk to right now. So we're much more enthusiastic about the opportunities that are out there today than, say, 9 to 12 months ago.

Operator: Your next question comes from the line of Tom Spiro with Spiro Capital.

Tom Spiro: I noticed in the 8-K filing today that yesterday the Board made a number of changes to the company's bylaws. And I was curious what led to those changes and what the thinking was?

Jeff Glajch: Actually, our bylaws had not been updated in a little while, and really the changes were to be more in line with some of the Delaware Corporation laws, so nothing really substantial in there. It was more cleanup activity.

Operator: Your next question comes from the line of Rick Hoss with ROTH Capital Partners.

Rick Hoss: Hi, a couple of follow-ups. First, Jeff, your SG&A commentary three to five per quarter, would that add, say, maybe 1.5 million to SG&A on a full year basis if we're thinking about fiscal '12?

Jeff Glajch: Oh, with regard to headcount additions?

Rick Hoss: Correct.

Jeff Glajch: Yes, again, of that three to five in the next couple of quarters, a good number of them are in the production area, so they would really fall under cost of goods sold. While we are definitely hiring in engineering, it's just a couple of individuals, and some of those costs would fall into SG&A. And there's a piece of that, the engineering cost, that is in the in the cost of goods sold category. So it's not a significant increase to SG&A.

Rick Hoss: Jim, there was no mention of China, I think, in the press release here. I know historically you've had a very good success rate in China, and certainly there's it gets a lot of headlines with refinery expansion, new builds, et cetera. Can you give us an update on what you're seeing in that market, and your role there and your position?

Jim Lines: We're still very positive about the long-term prospects in the Chinese refining market. It had been relatively slow for several quarters. We're seeing new bid work coming up now that hopefully will result in orders over the next few quarters. The pipeline of refinery expansions and grass roots facilities is quite large and multi-yeared, so we're very pleased with our success rate and our position going forward to capitalize on that opportunity.

Operator: Our next question comes from the line of Dick Ryan with Dougherty.

Dick Ryan: Say, Jim, just to follow-on to the Navy opportunity. You mentioned specifically submarines. Can you give us a sense of what that market might look like versus carriers, and what you need to do to start going after some of that business?

Jim Lines: To be qualified as a supplier for the submarine program, there are a number of things that have to occur. We've begun many of them. We've had meetings with the contractor and the procurement companies that will qualify us as an approved manufacturer. We also have some security clearances for individuals in the facility to complete. And that's a process that doesn't happen quickly, but we're moving on that.

And it really comes down to the belief of the contractor. In this case it would be Electric Boat along with Northrop Grumman, and the procurement company that does the purchasing of the vessels being satisfied with Graham's quality control, their production capability, and our commitment to a long-term strategy to support the Navy. And we've been very, very clear that we have a long-term vision to be a supplier to the Naval Nuclear Propulsion Program. They have our assurances that we're going to be in it a long time. We want to build a strong leg in our business supporting the Navy. And that's all part of our process, and it just takes a little bit of time.

Dick Ryan: What's the build cycle of a submarine versus carrier? I mean is there more in the budget for those platforms versus carriers?

Jim Lines: In general numbers, there's a carrier that starts construction about every five or six years depending upon Congressional budgeting, but that's roughly what the timeline is. One comes along every five or six years. The submarine has a greater frequency. There's one or two every two years. And the fleet for submarines is, well, we're reading about 30 of a particular class of submarine, and the carrier, the fleet is about 10.

Dick Ryan: And your dollar opportunity, how do you size that one versus the other?

Jim Lines: Quite honestly, I think in terms of all-in, if we look at the opportunities for carriers and subs, I think a carrier provides a little bit more. But I think they're comparable in terms of the accessible opportunity for Graham, if we can look at what we can provide with our engineering know-how, and or fabrication know-how, and our sub parts contract administration capabilities.

Operator: Your next question comes from the line of George Walsh with Gilford Securities.

George Walsh: Jim, is there any update at all in the oil sands market that has been mentioned or talked about previously as a potential area that could be a big area for the company? Anything going on there?

Jim Lines: That hasn't changed in the context of what we have voiced previously in that we continue to see investment that's happening on the SAGD side; the production. And that has to occur first before investments will be made in new upgrading capacity.

We see that new upgrading bid opportunities are moving forward. We're in some early stage bidding now for a few different upgraders. And we think it's moving at a pace that we had predicted, which we thought was around 2012 is where we'd see much on the upgrader side. But investment is happening on the production side, which has to occur first.

George Walsh: But it's 2012 forward in terms of being more meaningful for you?

Jim Lines: That's our expectation. We hope it's sooner, but that's our expectation, and our planning is around that.

George Walsh: And obviously it's influenced by the general price of oil anyway.

Jim Lines: That has an effect.

Operator: Our next question comes from the line of Brian Rafn with Morgan Dempsey Capital Management. .

Brian Rafn: Yes, just a follow-up kind of clarification question. You mentioned one or two submarines a year, I think what you're referring to are attack subs. Would you guys also be looking at talking to the Navy about the ballistic missile subs that are replacing the Ohio class Tridents?

Jim Lines: Yes, our focus on the submarine program, there's a Virginia class, there's the Ohio class, and then there's the next generation of subs. And we hope to participate in all of it.

Brian Rafn: Of the work that you're doing on the carriers and you talked about other vessels, would either the amphibious carriers, the Wasp class or Tarawa or the Littoral Combat Ships, would they also be in that broader vessel nuclear propulsion?

Jim Lines: At this point, Brian, we're focusing on the Naval Nuclear Propulsion side of the fleet, which is where there's specialized engineering know-how, specialized manufacturing. Not that the other vessels don't require specialized production of products, but we're making our focus in that area around the Naval Nuclear Propulsion Program.

Operator: There are no further questions at this time. I would like to turn the floor back over to management for closing comments.

Jim Lines: Thank you. We appreciate your time this morning and your interest in the company. And we look forward to updating you again in January.