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**Operator:** Greetings and welcome to the Graham Corporation Third Quarter Fiscal Year 2017 Financial 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. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Karen Howard, Investor Relations for Graham Corporation. Thank you. You may begin.

**Karen L. Howard:** Thank you, Christine, and good morning, everyone. Thank you for joining us to discuss the results of Graham's fiscal 2017 third quarter. We certainly appreciate your time today. You should have a copy of the news release that crossed the wire this morning detailing Graham's results. We also have slides associated with the commentary that we're providing here today. If you don't have the release or the slides, you can find them at the company's website at [www.graham-mfg.com](http://www.graham-mfg.com).

On the call with me today are Jim Lines, our President and Chief Executive Officer, and Jeff Glajch, our Chief Financial Officer. Jim and Jeff will review the results for the quarter and year-to-date, as well as our outlook. We will then open the lines for Q&A. As you are aware, we may make some forward-looking statements during this discussion, as well as during the Q&A.

These statements apply to future events and are subject to risks and uncertainties, as well as other factors, which could cause actual results to differ materially from what is stated on the call. These risks and uncertainties and other factors are provided in the earnings release and in the slide deck, as well as with other documents filed by the Company with the Securities and Exchange Commission. These documents can be found on our website or at [www.sec.gov](http://www.sec.gov).

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

And with that, I'm going to turn the call over to Jim to begin. Go ahead, Jim.

**James R. Lines:** Thank you, Karen, and thank you everyone for joining our fiscal 2017 third quarter results conference call. I will start at slide three as I begin my remarks. Sales in the third quarter were \$22.7 million, up 31% from the same quarter last year. Last year's third quarter was unusually low, and thus, not a recommended comparison for judging strength of revenue. Sequential quarterly performance may serve more useful in that regard.

Diversifying into new markets has been beneficial. In this quarter, approximately one-third of sales are from the U.S naval market and the nuclear power markets. There was significant improvement to gross margin when compared to the past two quarters. In our third quarter, gross margin significantly benefited from conversion of a non-typical order. This order was secured late in our second quarter and will be completed by the end of the fiscal year. An unusual or non-typical aspect of this order is its value, its high material content and the few production hours associated with the order. We don't expect to see such orders with any regularity.

Income for the third quarter was \$1.8 million or \$0.19 per share. As we exit the third quarter, we have a clear view for our fourth quarter. Full-year revenue expectations have now been tightened to \$88 million to \$92 million.

Please turn now to slide 4. You will note a rather consistent revenue trend for the past four quarters and that last year's third quarter, as I remarked previously, had been uncharacteristically low. Global energy markets continue to be weak, notwithstanding the improvement energy stock values have had the past couple months.

Sales to our oil refining markets were \$6.3 million in the quarter. Chemical industry sales were \$4.3 million and power market sales were at a similar level of \$4.4 million. Defense and other industrial sales in

the quarter were \$7.7 million. Geographic mix continues to have a high domestic sales weighting. Importantly, year-to-date, 25% to 30% of revenue is due to Navy and nuclear power diversification efforts.

I'll pass the call on to Jeff and he will provide a deeper review of financial results for the quarter and for year-to-date. Jeff?

**Jeffrey F. Glajch:** Thank you, Jim, and good morning, everyone. As Jim mentioned, our third quarter sales were \$22.7 million, up 31% when compared with the \$17.3 million in the third quarter last year. Please note that Q3 sales last year were unusually low and an easy comparable for this year.

Sales in the third quarter were 77% into the domestic market and 23% international. In last year's third quarter, the sales split was 62% domestic, 38% international. As Jim mentioned, approximately one-third of our sales were in the defense and nuclear markets in this most recent quarter, which drove the strong domestic sales.

Domestic sales increased 61% to \$17.5 million, while international sales decreased 20% to \$5.2 million. Gross profit increased to \$6.3 million, up from \$3.5 million last year due to the higher revenue level and improved gross margin, which increased to 27.8% from 20.3%, up 750 basis points. The improved margin was a combination of the benefit from the anomalous order, which Jim mentioned, that partly converted in the quarter as well as below comparable margin from last year.

SG&A spending was comparable to last year, but due to the higher sales level this year, it was 17% of sales versus 22% of sales last year. EBITDA margin increased to 13.6% from 12.6% in last year's third quarter.

While the gross margins were significantly higher and the SG&A cost, as a percent of sales, was lower, you may recall that last year we had \$1.8 million of operating income due to cancellation fees recovered related to a couple of projects. That cancellation income represented most of our EBITDA in last year's third quarter.

Net income in the quarter increased to \$1.8 million from \$1.2 million last year, or \$0.19 per share, up from \$0.13 per share.

Looking at slide 7 on the year-to-date results, sales in the first nine months of fiscal 2017 were \$66.1 million, down slightly from \$67.7 million in the first nine months of last year. Year-to-date sales were 74% domestic and 26% international compared with 65% domestic and 35% international last year. Domestic sales increased \$5.5 million compared with last year, while international sales have decreased \$7.1 million.

Year-to-date gross profit decreased \$3.3 million to \$15.4 million. Year-to-date adjusted EBITDA margin was 10%, down from 14% in the first three quarters last year. Net income adjusted for the restructuring charges, which occurred earlier this year, was \$3.7 million, down from \$5.6 million, or \$0.38 per share, down from \$0.56 per share.

On to slide 8. We continue to have strong positive operating cash flow in the first three quarters of the year at \$10.7 million. This level of cash flow, however, was significantly enhanced by an increase of \$6.7 million in customer deposits so far this year. We've paid \$2.6 million in dividends through the first nine months.

We've also had capital spending, which has been very light and under \$250,000 year-to-date, compared to \$883,000 in the first nine months of last year, which was also an unusually low level. We expect for the full year to spend approximately \$500,000 in capital. Given our strong operating cash flows and light capital spending, our cash balance has increased by \$7.6 million from the end of fiscal 2016 to \$72.7 million or \$7.47 per share.

We expect the higher level of cash deposits to markedly unwind over the next couple of quarters, as we procure raw materials for a few key orders. Therefore, it is likely our cash balance will be down to or below the \$70 million level, or approximately \$7 per share, within the next quarter or two.

Jim will complete our presentation by discussing the market outlook and our full-year guidance. Jim?

**James R. Lines:** Thank you, Jeff. I am now discussing slide 10. Orders in the third quarter were \$17.7 million, reflecting ongoing weakness in energy markets. There was a persistent low level of available opportunities to secure new orders. The decline in trailing 12-month order levels and the level of the bidding pipeline aren't an indication of a shift in our competitiveness or a change in our ability to successfully secure oil refining and chemical industry orders.

Our success statistics for large orders won versus those lost remains in our typical range. There simply isn't a large number of opportunities available at this time. Importantly, short cycle orders have pulled in and, in particular, aftermarket orders are down 20% to 30% compared to normal levels. Our bidding pipeline did pull in roughly 20% as well, and the aggregate value of the trailing 12-month bids is between \$600 million and \$800 million, compared to \$800 million to \$1 billion two years back.

Please move on to slide 11. Backlog is still very healthy at just below \$100 million. You can note the naval backlog totaled more than half of our backlog and, including backlog for nuclear power, the impact of diversifying into these two markets has been very important, as roughly two-thirds of current backlog is not from our traditional markets. The naval backlog, in particular, is long-lived with multi-year conversion. As a result, 50% to 55% of backlog will convert over the next 12 months and 35% to 40% of backlog converts two years from now or longer.

Please refer to slide 12. Guidance is tightened as we enter the fourth quarter. Revenue is expected to be between \$88 million and \$92 million, gross margin between 21% and 23%, SG&A expense between \$15 million and \$15.5 million, and the effective tax rate should be between 28% and 30% for the full year.

Christine, I would ask that you open the call now for Q&A. Thank you.

**Operator:** Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] One moment please while we poll for questions. Thank you. Our first question comes from the line of Joe Mondillo with Sidoti. Please proceed with your question.

**Joe Mondillo:** Hi, guys. Good morning.

**Jeff Glajch:** Good morning, Joe.

**Jim Lines:** Hi, Joe.

**Joe Mondillo:** In terms of the non-typical order that you cited, just wondering what end market was that related to.

**Jim Lines:** It's in our defense market. The non-typical nature of it has to do with the short conversion cycle and the lack of high-level of production hours that would accompany that level of order value.

**Joe Mondillo:** Okay. Any of that going into the fourth quarter?

**Jim Lines:** There will be some that carries into the fourth quarter. We do expect to have this order completed within our fiscal year.

**Joe Mondillo:** Okay. So, the fourth quarter should, maybe, be a little abnormally higher than sort of normalized levels of your core business also?

**Jim Lines:** I would ask you to think in the context of what our guidance is. We were projecting to have a rather light core business quarter, going back one or two quarters. The effect of this order that we did get at the end of our second quarter will benefit the fourth quarter. However, I don't believe that will be as strong as our third quarter.

**Joe Mondillo:** So, in terms of the guidance on the gross margin side, seeing that you mentioned that, I think the guidance is 21% to 23% and the low end of guidance would translate into something sub-20% level for the fourth quarter. So, I'm assuming that you're looking at the higher end and, if that's the case, 23% would be benefited from this sort of non-typical order that's falling into the fourth quarter. So, are you

seeing normalized gross margins at this point in time, looking at your core business, closer to 20% or maybe even lower?

**Jim Lines:** Let me come at this a little different way. We had debated internally the range of the guidance here for gross margin, because with one quarter to go it is relatively broad between 21% and 23%. We've talked over the past several years, Joe, that in particular, it's more severe as we're operating at the bottom of the cycle; work in production can't get redeployed with short notice. And when we're cycle-bottoming as we are, the amount of WIP that we have in production, the amount of different orders that we have in production is far lighter than normal times.

So, we have to take into consideration that unforeseen circumstance that we can identify right now where our customer may place a large order on stop and we can't deploy our resources into other WIP because there's not enough WIP. So therefore, we've tended to model that scenario into our range. However, to be more direct, we do expect to land near the upper end of the guidance range.

**Joe Mondillo:** So, what I'm trying to understand, because it's only one quarter and it's being partially affected by this non-typical order that you're citing, just trying to get an understanding of what we're looking at as a normalized run rate over the next couple quarters.

So, I'm trying to get, where is your margin for the core business, excluding this non-typical order? Is it lower than the higher end of this guidance? It seems like it is, after this non-typical order falls off. I'm trying to really get a sense of where your business is running at. And I know it's lumpy quarter-to-quarter, so obviously taking that into account.

**Jim Lines:** Sure. As we look at our backlog projection and the modeling of our quarters going into Q1 and Q2 of fiscal 2018, we would expect our gross margin to be in a range that's comparable to this guidance.

**Joe Mondillo:** Okay. I also want to ask a question, in terms of the refining business, which is your higher margin business typically and historically. The orders were the strongest in about five quarters, yet your commentary continues to be very cautious and probably rightfully so. But I'm wondering in regards to the fact that the orders were the strongest in some time, maybe it's a one-off quarter and we see a tick down again – your tone sounds like things are at least as bad, or maybe getting worse.

So, I'm just trying to get an understanding taking into account the orders that we saw in refining, where are we here? Do you think we're bottoming and that you're optimistic that maybe over the next couple of quarters we start to see improvement? Or have you not even seen a glimpse of the light at the end of the tunnel? And for whatever reason this quarter being a strong quarter in refining, is there a reason why you're thinking that things may stay low for a while?

**Jim Lines:** If we've telegraphed a more dire outlook than we have intended, that wasn't our intention. I generally don't see it at this point in time too much different than we would have characterized our markets in the past from a quantitative point of view. Qualitatively, as we think about our conversations with our customers and as they begin to discuss with us their investment plans for 2018 and 2019, we feel more positive. However, it's not expected to translate into near-term orders.

Now, for the level of orders that we had in our past quarter that are for the refining market, we did get fortunate to secure a mid-sized order for the Middle East for new capacity. It was very aggressively bid, very tight margin, but our team was able to pull that order in; that order could easily have gone the other way. There's not much like that in front of us as we look at our bid pipeline.

Another nice order that came in, which we see no repeatability in the short interval, is an oilsands replacement project that popped up and we secured it. We have a nice installation base up in the oilsands. You could envision the oilsands is not really investing heavily at this point with the price of oil. However, they do have a repair and replacement cycle that's every four or five years, and we benefited from that cycle fitting us just perfectly in the last quarter. I don't envision that carries anything like that into our fourth quarter or Q1 and Q2 of fiscal 2018 as it would relate to the oilsands market.

**Joe Mondillo:** Okay. That's great.

**Jim Lines:** I wanted to speak to what happened in the third quarter.

**Joe Mondillo:** Okay, perfect. Thanks for clarifying that. Just one or two questions left, and I'll let someone else have a chance here. In terms of the \$6.5 million order in the refining market that's still on hold, just wondering if you can comment on your confidence level of that eventually becoming active. I know it's only been 30 days essentially in this fourth quarter that we're in, but any sort of things that you've seen activity-wise that make you a little more optimistic or less optimistic at all?

**Jim Lines:** Okay. For the \$6.5 million of orders that are on hold, we do a quality check of those orders throughout the quarter and certainly as we enter the end of the quarter. We'll do that again as we go through the fourth quarter. One is for the bulk of the dollars, for Latin America. We have concern about the timing of when those orders will proceed and should they proceed; we'll update our perspective on the quality of those orders in our backlog throughout the fourth quarter. At this point, our judgment through the exercising of our due diligence in the third quarter was they're on hold and the project sponsors plan to proceed.

**Joe Mondillo:** Okay.

**Jeff Glajch:** Joe, you may note that there was a smaller order of about \$400,000 that had been on hold that we did release to be active. So, to Jim's point, we do a thorough review of these every quarter and our judgment is still the same at this point on those two larger ones, but on this – the one small one, we did actually release that into an active project.

**Joe Mondillo:** Yes, I did see that. Thank you.

**Jim Lines:** Joe, for your second question, as we're behind January now, the level of activity in January, I'm not going to quantify it, I would say more qualitatively it was no different and feels no different to us than the past few quarters. We're not expecting to see a blowout quarter by any measure in our traditional markets.

**Joe Mondillo:** Okay. Thanks a lot. Appreciate you taking my questions.

**Jim Lines:** You're very welcome.

**Operator:** Our next question comes from the line of Dick Ryan with Dougherty & Company. Please proceed with your question.

**Dick Ryan:** Thank you. Jeff, I had to step off for just a second. Did you talk about the impact of the non-typical order or how much that was in the top-line impact and gross margin impact?

**Jeff Glajch:** No, Dick, we did not and it's such that we can't really speak to it at any level of detail, unfortunately.

**Dick Ryan:** Okay. You said some was going to carry into Q4, is it a smaller percentage in Q4 than you saw in Q3?

**Jeff Glajch:** As Jim had mentioned, a portion will go into Q4 and it will impact and certainly help Q4. However, the underlying core business in Q4 we had expected to be very light in the quarter. So, it's not dramatically different, but it's going to have some affect in the overall quarter, and I think we would not expect to be at the level we had this quarter.

**Dick Ryan:** Okay. And, Jim, looking at the Navy, you talked about Navy and the other nuclear power being a-third of sales. Can you parse that out how much was Navy and how much was your other nuclear power business from the quarter, rough percentage?

**Jim Lines:** We reported power sales of \$4.4 million. So, that's an indication of roughly 20%. We reported sales to the defense and other industrial market of \$7.7 million, or about 34% of sales.

**Dick Ryan:** Okay.



**Jim Lines:** It was power, largely nuclear.

**Dick Ryan:** Okay. And looking at the Navy backlog, I know you quantified how the backlog generally should flow over the next year and two-year period. Can you give us a little perspective on how you see the Navy's backlog flowing through in fiscal 2018 and 2019?

**Jim Lines:** Sure. We have a couple of orders that we've been working through the engineering aspect of getting those projects ready to launch into production. With the naval work, that has a measured pace, that's not a go-fast marketplace, if you will; we expect to see those slipping one or two quarters for technical reasons that are outside of our influence. However, the work is there. Our team is focused on it. We have to just work through some procedural aspects of order execution that we cannot influence or move fast. And we are expecting to have a strong naval year, growth above what our highest naval year had been.

**Dick Ryan:** Okay. And what's the current status of the bid pipeline for the Navy? How do you see that timeline?

**Jim Lines:** We have some work that we expect to have closed in the next quarter or so. I think on a prior call, maybe two quarters ago, we projected that our naval backlog, which is now around \$60 million, will be somewhere between \$70 million and \$80 million as we exit next year.

**Dick Ryan:** Okay. Great. Thank you.

**Jim Lines:** Does that help?

**Dick Ryan:** Yes, sure it does. Thanks, Jim.

**Operator:** Our next question comes from the line of John Sturges with Oppenheimer. Please proceed with your question.

**John Sturges:** Thank you. Actually, a decent quarter, nice surprise. I'm just curious, looking back three quarters, is there a trend you can discern? Regarding the market in general, I see that short delivery has come up about 5%, which would suggest there's more maintenance spending going on as a proportion of the overall work. And then, it looks to me – because I do see some sign of recovery in oil and gas and the refining industry, that your percentage has been creeping up a little bit from, say, the June quarter. So, I'm just curious if there's any kind of a trend. It sounded like probably no surprises, but I was just curious if you could discern some kind of change?

**Jim Lines:** For our short-cycle work, which is typically something that would be one shipment in a quarter to four or five months, on the order side, which is, of course, a lead to the revenue side, that has pulled in about 20%. And for aftermarket as a whole, which has some short-cycle and some long-cycle work in it that's pulled in 20% to 30%. We have been mentioning that we don't believe it is an enduring pullback but there are point-in-time discretionary decisions by the owner operators to stay on-stream as opposed to doing the ordinary shutdowns for repair and maintenance.

That cannot, in our view, go on without correction. So, we're expecting to see improvement in that short-cycle work, in particular the aftermarket work, as we work our way through and into fiscal year 2018 starting in April, although nothing is in front of us to tell us that that's happening yet. Although I can share the quantitative measures of what actual orders are in the bid pipeline, it's not necessarily providing a discernible change in the past pattern of that market over the last couple quarters.

**John Sturges:** All right. I was just curious. Thank you.

**Jim Lines:** You're welcome.

**Operator:** Our next question comes from the line of John Bair with Ascend Wealth Advisors. Please proceed with your question.

**John Bair:** Thank you. Good morning, Jim, and Jeff. I have two questions. One is about your effective tax rate, you show on the slides of being 28% to 30%. So, I'm wondering if there's talk about lowering the

corporate tax rate to, pick a number 15%, 20% or whatever. I would assume that would benefit you quite a bit and I'm wondering if you've looked at that or tried to model that in your outlook?

**Jeff Glajch:** John, sure. I think it's too early at this point. Clearly, if there is tax reform, if the statutory rates go down, that would be beneficial to us since we are a pretty full taxpayer. What one doesn't know is what happens to other deductions and so forth. There's not a lot of things that we are able to take advantage of, to get our effective tax rate lower. Obviously, the R&D tax credit is one of them and from most of the information out there, if that would remain, that would be beneficial.

What we don't know is what else could be factored around the tax reform, with the general concept of lowering rates. Would that help us? Yes, absolutely, because we do pay pretty full rate. We have not modeled that into any of our forecasts. We certainly should consider it internally and we'll continue to do so, but we will have to wait and see the structure of the actual tax reform should it occur in 2017 or beyond.

**John Bair:** Would you be impacted to any extent by the proposed idea of a border tax on certain material that you might import or do you mostly source your materials domestically?

**Jeff Glajch:** Sure, John, that's a good question. I'll try not to get too complicated in the answer, though the answer is a bit complicated. We do import some of our material. There's a subset of our material that is imported and there's a subset that are not domestic suppliers. So, we continue to have to import, but at the same time if they go through the path that has been laid out for those sales that we export, there would be a benefit to us obviously. Because you wouldn't be paying a tax on the profit and you would have a benefit on the domestic content that was exported, again following what's been laid out at least in the Republican plan.

The challenge to all that is that, independently all that sounds potentially favorable, but then there's been a lot of talk that if that were to occur, you could see an effect. You should see an effect to the strengthening of the U.S. dollar, which would make our sales a little less competitive internationally. So, when you throw all that into one basket, it's hard to say what's the true impact of all this. I think, unfortunately, we probably have to wait and see a little bit, but there's a lot of moving parts that would likely occur should something similar to the cross-border tax be put into effect there. Again, I hate to be evasive by the answer, but there are too many things that you just don't know how they're going to move.

**John Bair:** Right and I understand that. I just was curious whether that was in your looking out there and what potentially might go on and how you might benefit or not from what's being thrown out there. The other question is, and I'm surprised nobody else has asked it yet, but can you give us any update on potential acquisition?

**Jeff Glajch:** John, we continue to be very active in the acquisition arena. I think we had mentioned this on the last few calls that we brought on a Director of Business Development late last spring and he is doing a very good job of building out our M&A pipeline as well as looking at some internal organic development opportunities.

Building that pipeline takes some time and unfortunately, we've not seen the significant reduction in pricing that sellers are looking for. There's been a little bit of an improvement, but not to the level that one would expect at this point in the cycle. All that being said, we've got a pretty good pipeline across all of our existing markets as well as some ancillary markets. I can assure you there's a lot of activity going on, but a lot of activity doesn't immediately lead to a result. You need some time to build that in, but all-in, we're pleased with the direction of our M&A activities. It will just take some time.

**John Bair:** Do you think some of the reluctance to lower the asked-prices for businesses is a function of a hope for turnaround in the manufacturing sector, given the outcome of the election and at least the apparent direction of more pro-business outlook in that regard? Do you think that will have an impact?

**Jeff Glajch:** I don't know. That certainly could be contributing. I think there is also a lot of available cash on the sidelines, particularly in the private equity world, that are looking at opportunities too. So, that tends to keep prices a little bit higher.

**John Bair:** Okay. Very good. Thank you much and good luck the rest of way.

**Jeff Glajch:** Thanks John. Thank you.

**Operator:** Our next question is a follow-up question from Joe Mondillo with Sidoti. Please proceed with your question.

**Joe Mondillo:** Just a couple follow-up questions. First, I was wondering if you have any sort of insight on potential expansion of any of your Navy businesses. I think there's been some talk of going to three submarines per year as opposed to the two in plan right now. Any insight or anything you're hearing regarding potential opportunities like that?

**Jim Lines:** Regarding our naval strategy more broadly, the team driving that strategy has a charter to expand and diversify our participation across the different vessels we are currently in, which would be a carrier and two different submarine programs. So, we are intent on utilizing our capabilities and how we differentiate our offering from the typical naval supplier to participate more fully in those areas that we feel we can.

Whether or not there will be an acceleration with how they procure the submarine program, as an example, my sense would be that it will be paced by the supply chain's capability to execute. And I think the supply chain is pretty stretched once there is a Virginia Class submarine and Ohio Class submarine moving forward, along with a carrier. So, my sense is, while there is a desire to move faster, the supply chain is not built out in any way to be able to do that.

**Joe Mondillo:** Are you talking more so about the entire supply chain or more so about your capacity?

**Jim Lines:** I was speaking more broadly of the entire supply chain to those programs.

**Joe Mondillo:** And then just to clarify, in terms of the aftermarket business, the trend that you're seeing, have you seen the same slight declines in the last several quarters? Or that 20% decline, is that more of a year-over-year decline and things have been more stable for the last couple of quarters?

**Jim Lines:** They've been stable at a contracted level over the last three quarters compared to normal.

**Joe Mondillo:** So, they're down 20% from a year ago, but the last couple of quarters, they're sort of stable.

**Jim Lines:** The last couple of quarters are stable, and they are down about 20% from the ordinary level that we had seen one year ago, two years ago, three years ago.

**Joe Mondillo:** Okay. Lastly, I was wondering if you could comment on the nuclear power-gen market that you supply into. What thoughts do you have on your outlook there? The orders have been pretty light the last couple of quarters and the backlog has been declining the last several quarters. Just wondering what your take is on what's going on there and what your outlook is.

**Jim Lines:** We've talked about the nuclear market and what it's experiencing as a whole. The market is looking to contract its supply chain and reduce its procurement costs. That's called the Nuclear Promise, which is an endeavor to lower the cost of procurement by 15% across the supply chain. We've also seen, because of uncertainty about the direction of natural gas and the use of that for power generation, the willingness of the utilities to invest as they had done previously. So, there is a slow down that we've seen. I don't necessarily assign what you've witnessed as a decline in our backlog to a change in our competitiveness or a change in our ability to win.

I think the market as a whole has tightened its purse strings and is trying to reallocate and shorten its supply chain down to two or three suppliers for different commodities as a way to reduce costs. And I think that's what we're experiencing. Longer term and I want to speak more broadly, because we spend a lot of time talking about our energy markets, which are a very significant percentage of our sales historically and as we go forward and will always be important. But I want to make sure it's understood that we aren't here waiting for the energy markets to recover. We know that they will. We are taking action within the energy markets to be prepared to capitalize when they do begin spending again.



Alan Smith, General Manager of our business in Batavia, has had his sales force spending much more time being plant-centric, or plant-focused, as opposed to EPC-focused, because that's where we believe the money will be spent first. Also, we're looking to reposition our brand and how we drive value into that market. So, we are focused on some leading activities. We're also developing strategies on how we participate more broadly and more fully, and increase our success capabilities in the international markets with some initiatives that we've embarked on to change how we execute those orders, to shift our costs lower and to expand our participation.

Again, we're laying the groundwork during this downturn to be different coming out of the downturn in that regard. Chris Johnston, our Director of Business Development, is building a very robust M&A pipeline that we are very excited about. That's keeping us more active in those discussions than we had been in our past. I mentioned that we're diversifying what we're going after with the Navy, which will be helpful. And now, for your question, the nuclear market. We see that long-term it is a great place to be, with value-drivers and how we provide value to an owner and user. It fits us extremely well, with high quality, specialized manufacturing, with a long sales cycle, and engineer-to-engineer. That's in our wheelhouse.

So, while they are in a contraction, we're looking at how do we take action during the downturn to reposition that business to come out stronger. I know you may comment that I was projecting a more dire outlook from either the intonation of my comments or how my words came out. We're very excited about the actions we're taking during this downturn to reposition this business, to grow more and to be ready when growth is available across our different markets. So, we're not sitting on our hands. And if that was a projection, that was my fault.

**Joe Mondillo:** Lastly, I tied into your answer in terms of going back to the question on acquisitions. Now that you've broadened the Company a lot more, compared to five-plus years ago, with the nuclear power and the Navy, has this changed your strategy or broadened your appeal in terms of M&A market and your strategy on how to expand the Company strategically given the growth and more exposure to these other sort of markets? I'm wondering at a higher level of strategy, how you're looking at M&A compared to how you were looking at M&A seven or eight years ago?

**Jim Lines:** We have a tremendous fondness for the diversification that we undertook and the beneficial impact it has had in this downturn. Had we not done that, this would have been disastrous. Therefore, we are looking to invest in our core markets with M&A and to further diversify long-term with changes in company earnings volatility. And the best way to do that is to take more of what's in the markets that we're currently in and diversify revenue streams. So, we are looking more broadly than we had thought about looking four to five years ago. I'm very fond of what we did over the last four to five years and the beneficial impact of naval and nuclear. At this point in time, it would be a rough rocky ride without it. But I want more of it.

**Joe Mondillo:** Okay, thanks a lot. Appreciate it.

**Operator:** We have no further questions at this time. I would now like to turn the floor back over to management for closing comments.

**James R. Lines, President, Chief Executive Officer & Director**

Thank you, Christine. I probably made my closing remark one comment previous to this. So, I just want to thank everybody for their time. I want you to be thinking about the initiatives that we have and appreciate that we're not just waiting for the markets to recover, that we are urgently trying to take action during this downturn to reposition our business for stronger growth and to capitalize and grow share when our core markets begin to recover. And I'm very pleased with where we are in that journey and the steps that we have taken. And I think our future still remains very bright as we work through this rough patch in the energy sector. Again, thank you for your time. Jeff and I will update you during our fourth quarter call. Thank you.

**Operator:** Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.