
Operator: Greetings and welcome to the Graham Corporation Fourth Quarter and Full 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. 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 Howard: Thank you, Christine, and good morning, everyone. Thank you for joining us to discuss the results of Graham's fiscal 2017 fourth quarter and full year. 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.

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 full year, 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.

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, it is my pleasure to turn the call over to Jim to begin. Go ahead, Jim.

Jim Lines: Thank you, Karen. Good morning and welcome to our fourth quarter and year-end earnings call for fiscal 2017. Please turn your attention to slide three. We had a strong fourth quarter with revenue of \$25.6 million. It was 15% greater than the fourth quarter last year. We completed a large non-typical Naval order in the fourth quarter. This non-typical order positively impacted the gross profit and gross margin for the quarter.

Net income in the quarter was \$0.18 per share, or \$1.8 million. Our fourth quarter performance pushed the full year to the upper range of our revenue guidance. Full year revenue was \$91.8 million and it was comparable to fiscal 2016 revenue. Full-year income was \$0.52 per share, or \$5 million, down from \$6.1 million for fiscal 2016.

Throughout fiscal 2017, we experienced a difficult pricing environment for large orders in our refining and chemical markets. This resulted in stiff margin headwinds that were partially offset by margin for the non-typical Naval order that benefited our third and fourth quarters. Lastly, fiscal 2016 had the benefit of \$1.8 million in cancellation charge income, which is not routine, nor was such a benefit in our 2017 results.

Please move to slide 4. Refining industry sales continue to be contracted due to the state of the downstream energy markets. In the quarter, refining industry sales were approximately half of what they were during the same quarter of fiscal 2016.

Chemical industry sales were up 15%. This is due to ongoing investment tied to low cost natural gas in North America that serves as a feedstock to the petrochemical and chemical plants in North America. We also had chemical industry sales for Latin America and Asian markets in the quarter.

Power industry sales were 19% of total sales, at \$4.8 million. Due to the non-typical Naval order sales, other industries' sales were reported at \$9.9 million, up \$3.3 million from last year, and up \$2.2 million from the sequential third quarter. We have completed this Naval order, therefore sales to our other industries will be lower as we move across fiscal 2018.

There was a high concentration of domestic sales in the fourth quarter due to nuclear and Naval sales being for U.S. customers. Importantly, 30% of full year revenue was from diversification strategies in nuclear power and Naval nuclear markets, that aren't correlated to our cyclical energy markets.

I'm going to pass it over to Jeff to go into greater detail about financial results. Jeff?

Jeff Glajch: Thank you, Jim, and good morning, everyone. I'm on slide 6. Q4 sales were \$25.6 million, up from \$22.3 million in last year's fourth quarter. The sales split was 78% domestic and 22% international compared with last year's fourth quarter, which were 60% domestic and 40% international. As Jim mentioned, the completion of our non-typical Navy order, as well as our nuclear business, favorably impacted the domestic sales in the quarter.

Gross margins were 26.3%, up from 20.4% last year. Adjusted EBITDA was 12% for Q4, up from 5% last year. Q4 net income and EPS were \$1.8 million, or \$0.18, compared with \$500,000 and \$0.05 last year. Again, all the profitability measures were favorably impacted by the non-typical Navy order that was previously mentioned.

On to slide 7. For the full year, sales were \$91.8 million, up slightly, or 2%, from \$90 million last year. Sales mix was 75% domestic, 25% international, a much stronger domestic weighting than the 63% domestic last year. Gross profit at \$22.2 million was down from \$23.3 million last year, due to the unfavorable mix which drove a lower gross margin at 24.1%, down from 25.8%.

SG&A was \$14.9 million, down from \$16.6 million last year. The \$1.7 million reduction was primarily due to lower commissions related to our sales mix, as well as cost controls and the \$759,000 insurance settlement which was reached earlier this fiscal year. EBITDA margin was 10.5% for fiscal 2017, down from 12.1% last year. Net income per share, adjusted for a \$0.04 restructuring charge which occurred in Q1, was \$0.56 compared with \$0.61 last year.

On to slide 8. We continue to have a very strong balance sheet. Our cash position in fiscal 2017 increased by \$8.4 million to \$73.5 million, or \$7.54 per share. We had strong cash flow from operations, as well as low capital spending in the year. We paid \$3.5 million in dividends in the fiscal year, continuing to have a \$0.09 per share per quarter, or \$0.36 per share per year dividend rate. Capital spending for the year was very low at \$300,000, down from \$1.2 million in fiscal 2016, which is also a low level.

You may recall in fiscal years 2014 and 2015, we spent over \$5 million per year as we pre-invested in capacity, and specifically in our Navy business. We expect capital spending to return

to a more normalized level of \$2.5 million to \$3 million in fiscal 2018. We are and will continue to look to utilize our strong balance sheet to opportunistically identify acquisitions.

With that, Jim will complete our presentation and comment on the market and our outlook for fiscal 2018.

Jim Lines: Thank you, Jeff. I will now refer to slide 10. Refining and chemical markets turned downward in the third quarter of 2015, and have remained contracted. Gross orders in the fourth quarter of fiscal 2017 were \$15.5 million, and net orders were \$9 million after adjusting for backlog cancellations that are related to two Latin American refining projects.

I have commented during prior conference calls that this particular downcycle in our energy markets, that include refining and chemical industries, has been the worst in my 34-year career. Since the start of calendar 2015, customers have cancelled \$24.5 million of orders that were in backlog, including \$6.5 million cancelled during the fourth quarter of fiscal 2017.

The order environment and impact of cancellations results in an underwhelming graph shown on slide 10. There has been a scarcity of opportunities. However, we are aggressive at securing what is available to hold or to gain market share, and to load our operations. The bidding pipeline is a healthy \$600 million to \$800 million. The amount, though, that is at an EPC bid or purchased stage, is not hinting toward a recovery that is imminent.

Please refer to slide 11. Approximately 70% of our \$82.6 million backlog at March 31 was for nuclear power and Naval nuclear markets. This, too, points to the severity of the current energy market downturn and to the importance of our diversification strategies that aren't correlated to energy. 45% to 55% of current backlog is planned to convert across the next 12 months, and 35% to 40% is planned to convert in fiscal 2020, or later.

On to slide 12. Guidance for fiscal 2018 is revenue between \$80 million to \$90 million, gross margin between 22% and 24%, SG&A of \$16 million to \$17 million, and a tax rate in the range of 30% to 32%. 2018 is set up to be a challenging year, including our fiscal first quarter in particular. The management team will control all that it can to positively affect financial performance throughout the year. My sight remains on how our Company is positioned for growth coming out of the downcycle.

I will continue to not trade longer-term value creation for near-term earnings. Energy markets will rebound, notwithstanding \$40 to \$60 per barrel oil. We cannot concede market share in the downcycle, and we must be ready to capitalize and take share when spending is stronger in the energy markets.

We have built an infrastructure to execute our Naval backlog. Those costs reside in cost of goods sold. We cannot unwind those investments given our current backlog and expected Naval backlog growth during fiscal 2018.

Our nuclear power strategy is about share growth and having capacity and capabilities to execute on that growth. The management team has built up the execution bench, and the learning curve is long in the nuclear market, so we are focused on leveraging those investments.

Lastly, Jeff and his team have built and continued to expand our M&A prospect pipeline. Areas of concentration are in the aftermarket space, Naval nuclear energy, nuclear power, and markets that will continue to diversify revenue. We aren't simply attempting to ride out this

downturn. We intend to be offensive, so that growth is strong when energy rebounds, whereas if the energy recovery is tepid, we will still grow.

Christine, please open the call for questions.

Operator: Thank you. We will now be conducting a question-and-answer session. Our first question comes from the line of Joe Mondillo with Sidoti. Please proceed with your question.

Joe Mondillo: Hi, guys. Good morning.

Jim Lines: Good morning, Joe.

Jeff Glajch: Good morning, Joe.

Joe Mondillo: First question is related to your final remarks, Jim, in terms of being aggressive to the point where you're best positioned for the upturn, if and when the upturn does finally come. What can you do internally at this point without acquisitions, so setting those aside, to position the company better? I know you expanded capacity right before this downturn and that was unfortunate timing there, but capacity-wise I think you're pretty well positioned. So, what more can you do to be better positioned for the upturn in terms of what you're doing internally?

Jim Lines: Sure. There are a number of actions that are being taken by the management team. In our Batavia operation, which is principally our energy space as well as our Naval nuclear space, we're looking at, and have implemented, process improvement.

In simpler words, it's about being able to execute more efficiently and have greater capability with our fixed costs. We're focused on implementing our QROC strategy, Quick Response Office Cell strategy, to co-locate key departments in an area to process the orders more quickly and seamlessly, and without the iterative cycle of how our sequential flow of orders happened in the past.

Secondly, we're using Franklin Covey's "4 Ds of Execution" to drive our execution implementation across the workforce, so they're aligned with our corporate strategies for process improvement, for error reduction, for lead time improvement. Ultimately, it all leads to better service for our customers.

In the operations area, there's a degree of cross-training, so our workforce is flexible. We do have surges in demand across our different products, so we want to be able to have a workforce that can align with the changes in demand, whether it's Naval, surface condensers, ejector systems, whether it's machining operations, or assembly and welding. We want to make sure that our workforce is cross-trained and able to adjust to surges or changes in demand.

Alan Smith, who oversees our Batavia operation, and his team, they've been focused under our roof line, now that we've made significant capital investments, on how we take the team we have and improve the efficiency with which they execute the orders. That's been our focus there, to ready the team, to have the right cost structure and the right productivity for stronger growth, not if it recovers, but when it recovers, because there will be a recovery.

In our nuclear operation, lead by Frank Helin, he and his team have deployed similar strategies around Quick Response Office Cells and project management initiatives, for again a quicker and more productive flow and order through the business. Our business is an ETO (engineered-to-order) business, and what throttles our growth to an extent is our capacity through the office.

So, we've been focused on how we unlock capacity in our office to execute more and to execute it more efficiently with less errors. That's what we've been focused on in this downturn.

Joe Mondillo: Okay. Then, the other side of the equation is external growth. Could you update us on the M&A initiative? I think it's pretty fair to say that the progress or steps that you've made with M&A have been a little disappointing over the years, just given that you haven't been able to close on anything. Is that a case in point and just the nature of your business, or should we expect something, or could you update us on what you're thinking is regarding M&A and the balance sheet?

Jim Lines: To a degree, we can't go into too many details. An important element of our process is financial discipline when evaluating the acquisition target. When the outlook in the near-term is on steady footing, it's challenging to work through the valuation in the first, second or third year post-acquisition. We have had some deals that we've gotten pretty close to concluding however, in the end, there was a separation in our evaluation of the value of the business, and we didn't break our judicious process for how we look at value creation, and the return on our investment, so we separated from those opportunities.

We will continue to do that. While we're eager to deploy our capital, we're not interested to do so in a way that elevates the risk profile of our business or, in hindsight, creates buyer's remorse. Therefore, we've been quite disciplined notwithstanding where the organic segments of our business are, and recognizing that external growth provides growth during this downcycle. We won't break our discipline. We've been very active, but we've been disciplined, Joe.

Joe Mondillo: Okay. Thanks. Then, taking Navy out of the equation, could you go through your three major segments of business in terms of oil and gas, chemical processing, and nuclear power, and rank, which one do you feel best about, and give us a little color regarding the portion of the \$600 million to \$800 million bid pipeline related to each of those segments?

Jim Lines: So, I'll step through it. We're talking about refining, chemicals and nuclear. I'll add to that, say, the aftermarket segment, so a fourth element. In our energy space, our team is still long-term bullish on refining, notwithstanding where it is at this point in time. Energy demand will grow.

Absent strong growth, there will be a clear focus in our view, from what we're observing from the capital spending by our customers, on leveraging what they currently have, getting more out of their existing facilities, meeting demands for more efficient or less environmentally unfriendly fuels.

Therefore, we're focused on the installed base, if you will, the existing operating refineries. There will be no capacity. However, over the next few years, we see the central focus for CapEx around sustaining capital as opposed to growth capital, and our sales force has been focused on this now for about two years. We got out in front of it to get closer to the plant level, which is where the demand will be.

So long-term, I still like refining, and I think it's a very important market segment for us, notwithstanding its cyclical nature and notwithstanding where it is today. That's where our differentiation is the strongest. That's where our margin profile is the best, and that's where our capture ratio has always been the strongest globally. There will be a recovery. Although, we're not waiting for that recovery sitting on our laurels, we are taking action. Looking at refining in the

long-term, I still plan to focus our assets toward the refining sector and be a dominant relevant force in the refining space for what we do.

Secondarily, and likewise in the petrochemical and chemical space, I echo the same sentiments there that I had for refining. North America is going through its investment in new petrochemical capacity. We benefited from that. We're now seeing the downstream investments behind the big ethylene plants or the methanol plants.

We have some of that going through backlog, and now we're seeing a building pipeline of the next wave of new ethylene capacity in North America. Will it be as strong as the first wave? I don't think so. But it's starting to stage up and we've had a strong capture rate and a nice margin profile there as well.

Globally, refining and petrochemicals will invest in new capacity because energy demand aligns with global GDP growth, and there will be global GDP growth. So, therefore there will be demand for new capacity, new plants, and we will win in those opportunities, just as we have in the past.

In the nuclear space, that market is going through an adjustment tied to low-cost natural gas. Actually, that's probably the root cause. There was a Fukushima event that slowed investment. Primarily, it's now around getting the economics right for the operating plants that are in place to be competitive with low-cost natural gas, enforcing cost improvement and productivity gains into the supply chain. I think there will be a shake-up in the nuclear supply chain. We plan to be a strong player, a relevant player in the nuclear market. We currently have a small share. Therefore, we're a small fish in a very, very large pond. We believe we know how to grow our share in the nuclear space, notwithstanding the supply chain pressures that are a result of the Delivering the Nuclear Promise[®] initiative that's being implemented in the nuclear market.

The aftermarket sector has always been a very stable area for us. It does have some cyclical nature to it, but it doesn't have the gross variation that we see in our large capital projects. We're bouncing off of a low period in the aftermarket. We've talked about that over the last few conference calls, several conference calls actually. We are anticipating and we are reading reports that CapEx or MRO spending will increase in the aftermarket space as we work through calendar 2017 and into 2018. Here, too, our focus is on concentrating our sales efforts at the plant level; we believe that will pay dividends.

I'm very encouraged across those four sectors that are not Naval nuclear. In terms of our bid pipeline, we're seeing petrochem stronger right now relative to refining. We think that's a point-in-time type of phenomena. They do tend to jostle and switch importance over a cycle – start of a cycle, end of a cycle, peak of a cycle – one can be stronger than the other.

Long-term, though, we see refining being very important, having about 30% or 40% of our sales mix. Chemicals, 20% to 30% of our sales mix. We don't see that changing and our bid pipeline suggests that there's no change there in the long term. I think I've answered the questions.

Joe Mondillo: Okay. Yes, that was really good. Thanks a lot. I appreciate that. Just one last follow-up and I'll jump back in queue. Regarding the aftermarket, MRO spending, maintenance piece, especially in the refining part of the business, I'm hearing that there are more turnarounds currently, even as we speak right now, plants coming down to provide some maintenance. I'm just wondering specifically regarding that topic, given the model of the overall industry, are you able to still fully capture what you've captured in the past? Is it just a case in point of demand coming back, or are refineries doing more in-house maintenance that's adding to the risk of the

aftermarket part of your business? Then, just to add to that, could you specifically provide a little more color on your commentary that you said at the end of 2017 - 2018, that you're hearing about future spending coming back?

Jim Lines: Sure. Regarding the turnarounds, our team, our sales team, our customer-facing team, they've been focused on spending more time at the plant level, as opposed to the EPC or major OEMs. We are having conversations about 2018 turnaround activity, 2019 turnaround activity. Regarding 2017 turnaround activity, we would've either won that or lost that, but we're now talking about the 2018 or 2019 turnarounds.

The refiners are still focused on yield improvement, which means getting more out of a barrel of oil and converting a barrel of oil into more transportation fuels. They're also investing in processing efficiently the different types of feedstocks, whether it's a heavy feedstock or a light shale-based feedstock. There will be investments to be able to operate the processed units efficiently.

We don't see a structural change in our ability to participate in that, or how that work will flow through the supply chain from a process shop to an EPC, to a supplier like Graham. We don't see that work going in-house. We still see the same participants along that value chain and we haven't seen an alteration in our ability to be successful there.

More importantly, with the investments that we're making to get closer to the end-user, spending more time with the end-user as they develop these turnaround concepts, we do feel that will support margin and will also result in strong capture rates, when money is spent.

Joe Mondillo: Okay.

Jim Lines: On the MRO side, the more routine spares activity, last year was down about 15% compared to the level of routine spare parts activity in the last four years. Margin has held up, but the volume was down about 15%. This cannot persist. Unplanned shutdowns, the safety risk, environmental risks are all very high. We feel that these are point-in-time delay decisions. They are not structurally changing the way in which they will procure spare parts. The reports that we've seen, there aren't many, but we've seen a few, they are suggesting a step-up in MRO spending in the refining space across calendar 2017 and 2018.

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

Jim Lines: You're welcome, Joe.

Operator: Our next question comes from the line of Brian Rafn with Morgan Dempsey. Please proceed with your question.

Brian Rafn: Good morning, Jim. Good morning, Jeff.

Jeff Glajch: Good morning, Brian.

Jim Lines: Good morning, Brian.

Brian Rafn: The Trump administration on the Navy side jumped out with a lot of discussion about a 350-ship surface Navy, but in the budgets, in general, it's just put a focus on parts and readiness for the first year. We're seeing a lot of cannibalization of Marine and Naval air wings, and fighters that aren't ready. I'm just wondering, as you guys have been involved with the Navy, if you've dialed back any of your expectations on shipbuilding in either the Virginia or the fleet strike carrier, or the new Columbia boomer, from what you've had, say, pre-election to now. It looks like we're getting a little bit of an extension on some of those delivery schedules.

Jim Lines: In a broad sense, no. We haven't altered our view of the build schedule. The one that's been difficult to nail down is the next carrier. You've heard us talk about that as the CVN-80 project. They were tending to build carriers on five-year cycles. We're now looking at that span between CVN-79 and CVN-80 to be more like seven years. However, the new administration is suggesting that they want to move to an 11 or 12 carrier fleet, which should shorten the intervals. This is not in the next couple of years. That would manifest itself more on a decadal basis as opposed to a couple of year basis. However, we view that very positively because of our position in the carrier and the size of those carrier orders for us. As an umbrella comment, Brian, we haven't seen a need to change the cadence at which we see our Naval revenue flowing.

Brian Rafn: Okay. Well, I appreciate that. With the new class of Gerald R. Ford-class fleet strike carriers, has your content changed at all? I believe you guys weren't on the Ford, you are on the Kennedy, and with CVN-80, the Enterprise, there's a learning curve to how they build these new Ford-class carriers. Are you seeing or expecting greater content if you were to be in the bidding process for CVN Enterprise, from what you've gotten from Kennedy?

Jim Lines: Our scope between CVN-79 and CVN-80 is anticipated to be comparable in terms of the type of product.

Brian Rafn: Okay. Right. I think you guys are very wise. You've certainly built capacity in your roof line. You talked about CapEx. You don't take the knee-jerk approach in putting a lot of talent out on the street and cutting head count. Are there things that you guys can do, maybe short-week cycles, 30 hours, 25 hours, furlongs, extended vacations, to buttress this period of slowness and retain the real content of your labor without sending your labor to the four winds?

Jim Lines: Certainly retaining our talented work force is paramount. Options to try to manage through this difficult downturn are available to us, so nothing is off the table. We will consider any avenue that allows us to preserve the long-term capabilities and the long-term value creation of the team that we've built. So, everything is on, a bit of à la carte, nothing is off the list.

Brian Rafn: Okay. All right. As you guys looked to fill in bid count activity a little bit, looking at the short-cycle work that is somewhat depressed, what are you seeing with the big projects?

Jim Lines: It can be a deceiving element of our business if you're not into the weeds like we are. Our quote count, which is an indication of how active we are, is fairly stable. It hasn't really gone up or gone down to any measurable degree. The aggregate value of our number of opportunities we're bidding monthly, on a trailing 12-month or 6-month total basis hasn't really changed. What is different is the aggregate value. Whether we're bidding something that's for example \$2 million, or we're bidding something that's \$500,000, the resources required to put that bid together, and comparably the resources required to execute that order through the office, are really no different. Therefore, the opportunity set in terms of number of opportunities, is the same. The aggregate value of the opportunities is down about 20% or so, but we're just as busy as we generally have always been with the number of opportunities. That's a unique aspect of our business, but when the value declines, and if our capture rate is the same, that map suggests revenue is going to decline.

Brian Rafn: Yes. I think it's a fair comment, Jim. With the Trump administration, the passage of the pipeline construction, the talk on opening drilling on public lands, certainly going after and shrinking the EPA, does that foster a better outlook for domestic oil and gas refinery with a little

more friendly fossil fuel strategy coming from the current administration versus Obama's administration?

Jim Lines: Certainly, Brian, as you hinted the sentiment is more favorable for fossil-based energies. The administration has that attitude. How that actually flows through to our customer and then through the bid pipeline and to orders, someone smarter than me probably can answer that question. Then, when it's a new administration, four years or eight years later, their view could be different as well.

The comments that we hear are more long-term in nature and directional as opposed to the immediacy of how they affect our business. I like the positivity of fossil-based focus, as it would relate to our business, how enduring the desires of the current administration is hard to say. I can't say.

Brian Rafn: Okay. All right. I certainly appreciate that. You said that in your 34-year career, the downturn and cancellations in the oil and gas sectors are as difficult as you've ever seen. On the back side, inevitably population grows, economies get better, GDP global growth will recover. How explosive and how much pent-up demand did you guys see historically, if you could put a little bit of a color or visibility on that? Do you think that the ramp-up might be slow and tepid, or might there be some real pent-up demand that you want to be in a position to capture once this moderation passes?

Jim Lines: The view that we have is the longer the contraction, the stronger the wave of new investment. When we think about the downturn before the last downturn, the 1998 downturn, which happened to span five years, that wave of energy-based investment was incredible, and we saw it building about two years before it manifested itself in terms of new orders and sales.

I'm not suggesting that plays out again, but the thesis would be as underlying demand continues to grow, and investment is not tracking that, that pent-up investment need will be met, and that's our long-term thesis as it relates to energy. I don't like a long downturn, because it's tough to manage a long downturn and hold on to your competencies with the realities of what that downturn means. In my position, I have to look through the downturn, make sure we do the right things in the downturn, but be ready for that eventual recovery and capitalize on it. So, a long downturn, in my estimation, results in a stronger wave of new capacity investment when it does occur.

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

John Koller: Good morning, gentlemen. How are you doing today?

Jeff Glajch: Good morning, John.

John Koller: Quick question on the SG&A expense. It looks like it's up a little bit year-over-year, and maybe I missed it in the commentary, but I'm just wondering if you can explain your expectation for fiscal 2018 over fiscal 2017?

Jeff Glajch: Hey, John. This is Jeff. If you think about our SG&A for fiscal 2017, which was \$14.9 million, we had the insurance settlement in there, which was almost \$800,000. If you back that out, our run rate was at around \$15.7 million, and fiscal 2018's guidance is \$16 million to \$17 million. We had a low commission level last year due to our mix of sales. So, our range is really based on adjusting out the insurance settlement, and then getting back toward a more normal mix on the commission side.

John Koller: Great. Thanks a lot.

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, gentlemen.

Jim Lines: Hi, John. Good morning.

John Bair: I've got two questions. The first one, going back to the nuclear power business, in the last 6 months - 12 months there's been a considerable number of announcements of projected closures in nuclear power plants. Of course I realize that the projected timeframe is 4-5-6 years, and there's a lot of discussion about issuing or creating zero emission credits (ZECs) at the state level for these power companies to try to figure out a way that they can keep these things running.

I guess the question is, if you have any sense what you feel the likelihood of those ZECs being created and issued, and how that might ultimately affect your nuclear power business, if in fact a lot of these plants are being shut down. I think I can think of six, perhaps eight offhand that have been announced.

Jim Lines: Sure. The U.S.-based nuclear fleet, one could bifurcate it to those that operate in regulated markets and those that operate in deregulated markets. Where you've been advised mostly of the shutdowns, it's been in deregulated markets, and whether those come to fruition or not, that will depend on how the state responds. You might recall that New York State leaned forward with the announcements of potentially one or two closing nuclear plants, and put in tax rebates that protected the profitability of the utility relative to the alternative electrical producing facilities.

So, there was another state that also responded in a similar manner. It will come down to the willingness of the states to lean forward in these deregulated markets to protect that fixed load, base load utilities that are environmentally friendly, that are up and running, and it can be dealt with in the rates that are being charged to the consumer, and how the state leans forward and supports that.

It's hard to fully understand the direction of this, because there are a lot of dynamics at play. We've seen, as I said, some states lean forward and other states, whether they do or don't, I'm uncertain. That is a risk. Let's play that out. Let's say 8 do eventually wind down, 8 out of 100. There is still a pretty large installed base of 90-ish or so operating plants.

We have a relatively small share of their spend. Our strategy is about getting more of their spend. Secondly, there will be a market created around decommissioning and handling the spent fuel from these shut down utilities. Is there an opportunity for us to play in that space that is becoming available should a shutdown of these power plants actually materialize? Our team is spending time understanding the decommissioning segment and waste fuel segment of the nuclear value chain. So, we aren't really altering our long-term view of where the strategy can go, John.

John Bair: Yes. That sounds actually more encouraging than I would have thought. To your point of trying to expand your market share, even in somewhat of a shrinking market, that could actually be a benefit to you then. Is that a fair statement?

Jim Lines: Yes, thank you.

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

Joe Mondillo: Hi, guys.

Jim Lines: Hello again Joe.

Joe Mondillo: So, I just have a couple of follow-up questions. Thanks for that. I just want to ask about the gross margin that you saw in the quarter that you just reported. I think the percentage of oil and gas revenue that you saw in the quarter was the lowest in over 10 years that you've seen in the company, and oil and gas usually carries the higher margin.

Seeing such a small percentage of the revenue being driven by oil and gas, I was surprised to see such strong gross margins. I know the quarter benefited from some Navy work, so I'm wondering if you could comment on that and if there is any change of expectations on the gross margin of your Navy work going forward, because I know you've said in the past that you expect Navy work to be a little under company average in terms of gross margins.

Jeff Glajch: Joe, on the gross margin for the quarter, you are correct about what you noticed with regard to the refining markets, and you are also correct that normally our Naval business is at a lower margin. However, the non-typical order that we had affected us favorably in both the third and fourth quarters. The Naval order was at a higher gross margin than normal Navy work, and that's what helped us in the quarter. We also mentioned that it helped us last quarter, but that does not change our expectation going forward of the normal Naval gross margin.

Joe Mondillo: Okay. In terms of your outlook for the Navy business itself, you mentioned in your press release that you anticipate \$9 million to \$12 million of revenue to be converted in fiscal 2018. What was the Navy revenue in 2017 and can you give us ballpark expectations on what you're looking at relative to what you have in backlog for fiscal 2019?

Jim Lines: The 2017 Naval revenue was about 15% of sales, and our backlog conversion, as you noted from our press release, is estimated to be between \$9 million and \$12 million. In addition to that, we are expecting to win orders in fiscal 2018 that contribute to the revenue in fiscal 2018. So, from a modeling point of view, we would expect year-over-year to be between 85% to 100% on a comparable basis. However, we don't have that work in our backlog yet, the additional work.

Joe Mondillo: Do you expect the Navy to be down in fiscal 2018 relative to 2017?

Jim Lines: We expect it to be between 85% to 100% of 2017.

Joe Mondillo: Okay. Then 2019?

Jim Lines: As we think about 2019 and 2020, compared to 2017, we expect growth relative to 2017's number.

Joe Mondillo: Okay. I think we've talked in the past about the fact that you could've achieved \$20 million to \$25 million. Is that \$20 million to \$25 million on top of the \$14 million, or \$20 million to \$25 million total?

Jim Lines: That number that we've cited in our conference calls or in our investor information, that would relate to total Naval sales in a given year.

Joe Mondillo: Okay. Just lastly on that topic. I'm surprised because I was anticipating Navy to be a ramp up going forward. Why is 2018 down from 2017?

Jim Lines: We haven't lost it. We've not been able to secure the next large carrier order; it's a function of timing.

Joe Mondillo: Okay.

Jim Lines: You might recall in 2009 when we secured our carrier order, it was in the order of \$25 million. We've spent a good part of 2016 and 2017 being ready so when that does come, we're able to put it quickly into operations.

Jeff Glajch: Joe, I think there's one additional point here too that we had expected. If we went back 12 months from now, we had expected fiscal 2017 to have less revenue than fiscal 2016, but because of the non-typical order that we've discussed last quarter and this quarter, that actually led to significant year-over-year growth from 2016 to 2017, that was not anticipated at the beginning of 2017. So, that step-up that we were expecting from 2017 to 2018, actually occurred from 2016 to 2017.

Joe Mondillo: Okay. Makes sense. Lastly, do you see any risk of not winning the carrier?

Jim Lines: Well, until it's won there's always a risk. We are very confident in the dialogue that we've had, but with complete candor, until the order is in our backlog, there's always a risk of losing it.

Joe Mondillo: Sure. Okay.

Jim Lines: We feel very confident.

Joe Mondillo: Okay. Great. Thanks a lot. Appreciate it.

Jim Lines: Thank you, Joe.

Operator: Our next question is from John Bair with Ascend Wealth Advisors. Please proceed with your question.

John Bair: So, it actually sounds a little more encouraging than I would've anticipated with regards to the nuclear plant and what's going on there. I have another question. I was rather impressed at a visit up there in Batavia about your plaque of longtime 20-year plus employees. I'm just wondering, given this long drag out and the operating overhead pressures and so forth, are you finding it difficult to replace those that perhaps are retiring or can you address the manpower aspect of keeping everybody cross-trained, and that kind of thing?

Jim Lines: Sure. I'm going to address it from the perspective of where we saw risk and what we've done. There had been a long indoctrination and training cycle to bring new employees into production roles or office roles, engineering, design, drafting. Five or six years ago, we identified that as a strategic risk that would impede our growth. The human resources department and the management team put together an onboarding and training program to bring new employees into our company and develop them to be proficient more quickly.

When I joined the company 34 years ago, your freshman orientation period was 3 to 5 years long. Now, through the steps that we've taken, that freshman orientation period is somewhere between 12 to 18 months. So, we've gotten that, putting our know-how into our processes and providing training tools that allow an employee to join our complicated company and become proficient more quickly.

Secondly, employees are the backbone, of course, of every company, and they're the backbone of our company. We needed to recast Graham as an employer of choice in our community so

we could attract the talent whether it be the welding personnel, the machining personnel, production labor, engineering, accounting, or sales. Our HR folks did a great job of recasting the Graham brand as a strong employer, a company that challenges its workforce, engages its workforce, holds them accountable for driving the strategies and making them part of the strategic growth. So, we've repositioned our company in terms of how we attract and retain talent.

I think in response to the question that you've asked, we've done a good job to prepare for the consequences of that plaque that you saw, which lists the 25-year employees and the loss of know-how. We got that somewhere about a decade or a half of a decade ago, and have done a good job to mitigate that risk around retention, thus, a seamlessness with which we move forward as we lose long-tenured employees. I'm not going to say it doesn't hurt when you lose a veteran of 30 or 40 years and their knowhow. They've been there and done that, have seen situational circumstances and know how to navigate them, but we've done a great job in transferring the know-how more quickly to the newer worker.

John Bair: That's good. It's encouraging when the upswing eventually comes. You don't want to be caught short there, so that's very good. I appreciate that. Good luck going forward.

Jim Lines: Thanks John.

Operator: Our next question comes from the line of Brian Rafn with Morgan Dempsey. Please proceed with your question.

Brian Rafn: Yes. I think you talked about CapEx for the next fiscal year being \$2.5 million to \$3 million. Just wondering where that is maintenance-wise, capacity-wise, what kind of targets are you looking at spending on?

Jim Lines: A large chunk of that relates to our Naval growth strategy, and some new machine tools that allow us to do certain parts more proficiently. We made an investment with the CVN-79 order, and we're hopefully making a comparable investment in support of the CVN-80 order, that provides our workforce with the right tools to deliver the appropriate quality that the Navy mandates. So, about 2/3 of that CapEx is around our Naval strategy.

Brian Rafn: Okay. You said that you thought your content would be similar between CVN-79 Kennedy versus the Enterprise. Are there any cost savings or time savings that you have on preliminary bids with the Navy between carriers, that if the programs don't change engineering specification-wise, that there's not a ton of wasted time and effort in the uniqueness between one carrier to the next? I'm just wondering if you were to lose that, how much is wasted time in effort other than just discussions.

Jim Lines: CVN-78 was the first vessel of that class, then CVN-79 was awarded while that first generation was being built. Once a design was set for the vessel, there still was some engineering churn. As you get into the third, fourth and fifth, they're build-to-print, and the innovative engineering is pretty much behind.

Now for the Columbia, which you had mentioned as an example, that's all next generation design. There's an immense engineering effort there that will go across the first sub, and probably into the second sub. Then, of course, the Navy is always looking for productivity, cost improvement, and that's a value they see with Graham as we bring our commercial sensibilities into the Naval market. We're constantly thinking of that and challenging it. Why is it this way, why can't it be that way? We can do it more efficiently this way with less cost.

We bring a perspective of design for quality and design for manufacturability and cost reduction that the Navy does value. It's important that we share with everyone that we bring a new perspective to the Naval supply chain for which they see a great deal of value, that is being competitive and driving cost down without comprising quality.

Operator: Thank you. Ladies and gentlemen, due to time constraints, we have reached the end of the question-and-answer session. I would now like to turn the floor back over to management for closing comments.

Jim Lines: Thank you, Christine, and thank you, everyone, for your questions and time on the call today. We appreciated updating you on our fourth quarter and full year results for fiscal 2017, and we look forward to catching up with you on the next conference call. Thank you.

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