Jeff Glajch: Good morning, everyone. My name is Jeff Glajch. I'm the CFO of Graham Corporation, and I'm here to talk about the company. If you look on slide 2, you'll see we have our Safe Harbor statement. I'm not going to read it, but I will obviously be making some forward-looking statements, so please take the chance to read through this if you could.

I'd like to take you through our business and our strategic outlook for the company. Graham has been in existence since 1936, so a little over 80 years. We make engineered-to-order products for the energy markets. Our key end markets are the refining market, petrochemical market, the power market, particularly the nuclear power market, and we provide equipment for certain vessels for the US Navy. We have a market cap of just over $200 million and just under ten million shares outstanding.

I also want to mention our fiscal year ends on March 31st, so if I'm referring to fiscal year 2018 that ends at the end of this week.

The equipment that we make is critical to our customers. It has a high cost of failure. What does that mean? What it means is that if our equipment doesn't work, our customers' facilities are not operating at the level they're designed to operate at, and it's costing them a lot of money. It's important to them that the equipment that we provide starts up right, works consistently, and is very predictable. If any of those fail or do not work as designed, it causes a significant problem for our customers. Because of that, they rely on us for the engineering that we provide, to make sure that our equipment works with their equipment, and then they rely on us to fabricate equipment that meets those engineering specifications.

I talked about our four end-markets. We have some key differentiators that we believe drive value for our company and drive value for our customers.

First off, we have a consultative selling process. What's a consultative selling process? Well, if you think about a refinery, a petrochemical plant, if you were to say I'm going to build one today, it would be operational perhaps in five years. During that time period, our equipment would be ordered about two years into that five-year time period. A very important thing that we provide to our customers during that two-year time period before our equipment is ordered is we provide engineering support. We provide the support that helps our customers understand how our equipment will work with their equipment, how we will design it, what the tradeoffs are between operating and capital costs for our equipment, and how to best optimize the operation of their facility utilizing our equipment. That is a service that we provide typically for free during that two-year time period.

We feel it's very valuable for a number of reasons. One is we help them design the equipment that's going to be used in their system. Secondly, we have a better understanding of the competitive situation. So there may be certain situations where we're really the only person who's going to be in it, where there may be other situations where there's three or four who will be equally weighed.

Our competitors don't provide the selling and engineering support early on, but at the end of the day when there is an RFQ that comes out, they still may be allowed to bid, and it's very important for us to understand what our true position is. It allows us to price our equipment accordingly. Certainly, if it's a price-driven competitive situation, we may price one way. Whereas, if it's a situation where we're essentially the sole source, we may be able to price it slightly differently.

It also allows us, very importantly, in many cases to get the last look. So if we're not, by price reasons, the chosen supplier, we're often given an opportunity to match, or maybe not match, but perhaps to adjust our price a little bit and ultimately win the business. So we believe that consultative selling process is valuable for our customers and very valuable for us.

Complex project management, that's something that we're very, very good at. If you think about our equipment, a lot of companies, they'll take an order for a piece of equipment, they might do some engineering work, and then they'll start fabrication. Their goal is to get from fabrication to completion as fast as possible. That of course is our goal too, however, it's not that simple.

Many, times we'll start fabrication and part way through it our customers will reach out to us and say, "We've had a change in our facility. We need to adjust our equipment a little bit." We may stop our production. We may need to adjust our engineering and then start our production back up. That start and stop nature of the engineering and of the fabrication of our equipment, that's something that we do very well and that many manufacturers have a lot trouble and are very uncomfortable with.

We have a responsive operating model. What I mean by that is we have a very low volume, very high mix of opportunities. So we can adjust our operating model, our engineering team and our fabrication team to meet our customer's needs, all of those are very important to the customer.

Finally, our fabrication is to very tight tolerances. I noted one of our key end markets is the US Navy. This is the equipment that goes on nuclear carriers and nuclear submarines. A nuclear carrier will operate for 50 years. Where our equipment goes it can't be taken off, it's essentially in the bottom of the boat. When you've got something like that, you can't have equipment that you expect to replace. You have equipment that has to operate for 50 years and it needs to operate well.

To do that you have to meet specific, very, very tight tolerances. That's important in the Navy but, quite frankly, that's also important from a quality and from a safety standpoint in the commercial markets. So we're able to do that. We provide consistent, strong quality control, and our customers rely on that and, quite frankly, our customers pay us for that.

Talking about our projects, I like to bucket our projects really into two areas. I'll call them large orders and short-cycle orders. Large orders make up about two-thirds of our business. The average selling price is about $800,000. But it can range from the low-end of a quarter of a million dollars to, on the commercial side, typically the high-end might be $5 million or $6 million. There will occasionally be a one-off project that will be significantly greater than that, perhaps $10 million or more. Then we have the Navy opportunities which can take us as high as $30 million. Those are our large projects.

On the commercial side, order-to-shipment is typically 9 to 18 months. The first half of that 9 to 18-month time period is engineering time. We do not recognize any revenue during that time period. We start recognizing revenue when we start our production, our fabrication. We tie our revenue in most cases to direct labor hours. So if we have a project that has, as an example, 2,000 direct labor hours and we've completed half of those, then we'll recognize half the revenue, but very importantly, that revenue does not start until we actually start fabricating our product.

The Navy orders have a longer timeframe. They typically have order-to-shipment of two to five years, sometimes it's even longer than that. They have often much more time upfront in engineering than a few months or six months. They might have a year, a year and a half of engineering work upfront. So while the Navy orders and backlog are fantastic, once we take an order, in many cases, that first dollar of revenue may take a year or even longer to see.

The short-cycle orders are about a third of our business, with average selling price of less than $10,000. It can be an order for $1,000, it can be an order for $20,000 or $30,000. These are typically pieces of equipment that order-to-shipment can be within a quarter or within two quarters. It's a very predictable business for us. Does it fluctuate? Certainly it does, but it doesn't fluctuate from an order standpoint or from a revenue standpoint to the magnitude that some of the larger orders do.

I've talked about our four key markets. I'd like to go into a little more depth on each of them. The crude oil refining market is a very keen market for us. We have a very strong share, perhaps about 25% globally. We have a stronger share here domestically, a very good share in the Middle East, certain

Asian markets particularly China we have a very strong share. We don't play in the European market too much, because our competitors are European and we would have to win on price in those markets.

Where do we get business? In some instances, we get business from new capacity. We also get business from revamps and retrofits, and of course we get spares and replacement business which is our short-cycle business. I want to focus a little bit on the revamps and retrofits.

What we're seeing in North America today is not necessarily significant capacity expansions, but more recently some of the orders that we've taken over the last quarter or two have been revamps of existing facilities where the total cost to the customer of what they're spending is obviously dramatically less than what a new capacity would be. But for our equipment, they're essentially replacing our equipment in total. So the opportunity for us is very similar even though the total capital for the entire project, for all the things they're doing in refining, is significantly less. We believe the revamps and retrofits are very likely to drive activity on the refining side particularly here in North America over the next couple of years.

In petrochem, there's been significant investment over the past four or five years in the domestic market as low-cost natural gas has provided a fuel and a feed stock. It's feed stock for ethylene, driving new capacity investment in North America. We think that's pretty significant, and certainly we took advantage of that in our fiscal years '14 and '15. As we expected, we've seen a little bit of a lull for a while, as the market absorbs this additional capacity. We think there's perhaps a second wave, not as strong as the first wave, but a second wave that may be coming in the next couple of years domestically.

We also see some downstream investments that are occurring in the petrochem market domestically, and we're starting to see some opportunities outside of North America. So the petrochem market's been a little slower just because they've been absorbing that capacity that's been put in over the past few years. We think that will come back, but that may be a little further out than some of the refining opportunities.

The US Navy, we're very excited about. If you look at our total backlog, approximately half of it right now is US Navy opportunities. Most of what's in there right now are submarine projects. There is a nuclear carrier that we have been doing some work on, and we have the opportunity to get the rest of that award. And that should be awarded very, very soon. We expect it within the next quarter or so. We've been expecting it for a little while and it was pushed out but, rather than getting nothing, we've been getting some introductory pieces of that. So that's an opportunity that's coming forward.

The submarine work that has been in our backlog for a couple of years is now really starting to come to fruition, and in fiscal '19 will even more so. I talked about how the engineering cycle can be a couple of years for some of the Navy work. That's what we've been working through on the submarine side, a lot of the engineering work over the past couple of years. Now, we're really going to be in full fabrication on both the submarines and hopefully on the rest of the next carrier.

So the next few years for the US Navy are very encouraging for us. We've been sitting on a lot of backlog. We've been converting a small portion of it. We're going to start seeing bigger conversions in fiscal '19 and fiscal '20. This is a business that we believe by fiscal '20 should be north of $20 million. We may not get there in fiscal '19, but we'll be getting closer to that range in fiscal '19, but by fiscal '20 and beyond, we believe there's an opportunity there, and we believe there's even greater opportunities going forward.

The power business is probably the one area that we're a little less optimistic about, the nuclear power business particularly. The domestic nuclear power plants have been spending less over the past couple of years, and we don't see that accelerating significantly in the near term. The new builds in North America, two of the four reactors that were going to be built, they've decided not to move forward on, partly as a result of the bankruptcy of Westinghouse as well as significant costs and schedule overruns.

So we're looking at that business right now as a business that we're going to operate to generate cash. We're going to look to opportunistically take advantage of where we have strengths in that market and try to garnish some additional share but, of the four markets, that's probably the one that we're the least optimistic about. The other three, we have clearly more optimism going forward than we've seen in the last couple of years.

I talked about the early signs of market recovery. If you look at the quarter that ended in December, we had a very, very strong order quarter, in excess of $40 million. I believe it was the second largest quarter we've ever had in orders, and if you look at the orders excluding the US Navy, it was the largest quarter we've ever had.

The reason I excluded the Navy is, sometimes we'll have very, very large lumpy orders for the Navy. As we did a couple years ago, we had a quarter where we had $50 million in total orders but over 70% of it was with the US Navy. This past quarter with $40 million of orders, only about 10% of it was with the Navy. The rest of it was in our commercial market, primarily the North American refining market.

We saw a number of projects move forward. We talked about on our earnings call in January that we would expect the current quarter that we're in to have significant strength, not necessarily the order level we saw in the commercial markets last quarter, but still a good quarter. We would expect to see backlog growth in this current quarter.

Also very importantly, we believe that the quarter that we're finishing up this week and the previous two quarters represent the bottom of the cycle. The cycle started going down about three years or so ago. Our fiscal '16 was kind of rough. Our fiscal '17 was kind of rough, and quite frankly, our fiscal '18 was the roughest of the three, but we believe these three quarters ending this week represent the bottom of that cycle.

As we look to fiscal '19, although we've not given specific guidance to fiscal '19 yet, we do believe we will see growth in fiscal '19. That confidence is based on the backlog that was in place at the end of December as well as what we've seen in the current quarter. So we're very optimistic about fiscal '19 relative to fiscal '18, and we believe we're out of the depth of the trough.

As we move forward, we're looking obviously for strong revenue growth, looking to get back to our targeted average EBITDA margins of 17% or above and return on invested capital of 12% or above. Not suggesting at all that that occurs in fiscal '19 but will start to head in that direction and get there as the recovery continues.

Our backlog at the end of December was about $96 million, about half of it with the US Navy, the other half in our commercial markets. As you can see, the majority of what was in our commercial markets was in the refining market. If I look back at our backlog at the end of June or the end of November where it was about $73 million along with being as low as it's been in quite a long time, what was very disconcerting at that time was that, of that $73 million of backlog, about $50 million was Navy which was great, but that says that we had barely over $20 million of commercial backlog. That's the lowest our commercial backlog had been since the mid-2000s. That was very disconcerting and concerning as we looked forward.

The step up in the last quarter from $73 million to $96 million, that $23 million step up, that was all commercial backlog stepping up. So our commercial backlog today is about $47 million, $48 million at the end of December, obviously much better than being in the low 20s. We'd like to see that move up further, and we're hoping to see that move up further in the near term. So we'd like to get that commercial backlog up as well as having that strong Navy backlog.

Regarding our backlog conversion, about 55% to 60% of it will convert over the next 12 months. The portion that doesn't convert, the other roughly 40% is primarily the Navy. The Navy, we'll see some conversion in fiscal '19, but a lot of it will stay in backlog just because of the nature of the Navy projects. So as I said, we're more optimistic than we have been in quite a while. Are we at a full recovery yet? We're not ready to call that. Certainly, if we have a number of quarters in a row of good opportunities and good orders, we'll make that call, but it's certainly a lot better position today than we were 6, 12, and 18 months ago.

We've done a number of things, and I'm not going to go through all these just for the sake of time, but during this downturn we've done a number of things to strengthen our performance going forward. We look at the downturn as an opportunity to reinvest in ourselves, to identify those areas where we can invest and improve our business. We've done a number of things you can see here all of them really focused on four areas: topline growth, profit improvement, trying to reduce earnings volatility, and ultimately create greater customer value. We've been working on things like lead time reduction, improvement of our continuous improvement programs and our sales structure, and then areas such as M&A where we continue to look for inorganic growth opportunities.

Our acquisition strategy that I just mentioned briefly a second ago, we have about $74 million worth of cash, not quite $8 a share but pretty close. We want to put that cash to work. We've been talking about it for a long time, but at the same time, we don't want to make an acquisition just to check the box, be a hero for a day or for a quarter, and then a year or two later look back and say, "Wow, why did we do that."

We're very disciplined in our approach. We're looking for engineered-to-order product companies for the energy markets like we do, a company that has a customer and quality focus like we do, a revenue range of $20 million to $60 million. We're not going to be somebody who's going to overpay, so if you're paying seven or eight times EBITDA and you're buying somebody with a low-double-digit to perhaps low-teen EBITDA margin, you're probably going to pay roughly dollar for dollar of revenue. If it's higher EBITDA margins, we'll certainly pay more, but we're not going to be paying 10, 12 times EBITDA, that's not our focus.

Our focus is not necessarily to just be accretive, that's an awfully low bar when you're in a low interest rate environment. Our focus is to get a cash return that exceeds an equity type cost of capital. If you do that and you manage your balance sheet as you'll see we manage our balance sheet, you get a heck of an accretion to your business. That's the focus of our acquisition program, and we're going to keep that pricing discipline.

I can tell you over the past year and a half we've walked away from a couple of opportunities that we went very far down the path on. If I think about it and use a football analogy, we probably got down to the ten-yard line. We could see the goal line, but it wasn't the right fit for one reason or another, and we ultimately peeled off. Far too many companies when they get past midfield their only measure of success is closing the deal. Our measure of success is closing the deal but the right deal, and if it's not the right deal, we'll peel off of it. We felt very comfortable making those decisions to walk away from something we liked but we just didn't like the fit in our company.

I want to do a quick financial overview to give you a little bit of an idea of where we've been and where we're going. If you look at our profitability over the past five years, you see we peaked in our fiscal year '15. We saw a drop-off of a third in our top line in fiscal '16, yet we remained profitable. We stayed at that level in fiscal '17 and also remained profitable. Fiscal year '18, based on our guidance, we'll see an additional drop-off on the top line of over 20%.

We made money in the first quarter. We've about broken even the last couple of quarters. We suggested in our guidance that we're going to be close to breakeven in the fourth quarter also. As I said, we're at the bottom of the trough, and we would expect fiscal '19 to see significant top line growth and significant bottom line growth, not just on a percentage basis bottom line but rather on a true dollar basis. Again, we will be providing detailed guidance for the year at our year-end earnings call at the end of May, but we do see optimism ahead in fiscal '19, which is not something we can say we've seen for a few years.

Our balance sheet I've talked about a little bit. We have $74 million worth of cash. We have no bank debt. Even in this down time period, we've continued to generate operating cash. Because we have low capital expenditures and we have a business that has a low working capital utilization, as we start to see growth and we start to see profitability, that cash should add to our balance sheet.

As we move forward, we expect our working capital to be at its normal 0% to 10% of sales range. Our capital expenditures, we typically spend $2 million to $3 million a year. We've spent a little less the last couple of years. We expect to be in that type of a range going forward. So as we start to get into recovery, start to see earnings pick up, we don't expect to need a lot of capital to generate those earnings. Our capital is a little bit more than our D&A but not that much different, so we don't really need it there. Again, we don't expect to need a lot of money for working capital.

Cash generation is important to us. If we look just over a decade, if you went back to about 2005 you'd find we had a net cash position of just under $1 million. In that time period, we've generated over $106 million of net income. Many companies will generate a lot of net income, and you'll look and say "Where did it go, what happened to it?" If you look at our case, about three quarters of it ended up on our balance sheet today as cash, another $18 million was used for an acquisition which helped grow our business. So when I put those two together, you've got over $90 million out of $106 million that is either on our balance sheet as cash or is reinvested in an inorganic opportunity.

Where did the rest of it go? We've increased our dividends significantly over the past three or four years. We're now paying a consistent $0.36 a share, or a yield of a little under 2%, much higher than we paid in the past, and we intend to continue to pay that dividend going forward. So it's very important to us not to just look at our P&L and say "Hey what does this look like", but rather we want to generate cash. That ultimately is what's giving a return to our shareholders.

Our capital allocation priorities are very simple. If we look at end-year capital, we want to use it for organic growth, namely capital investment to reinvest in our business. As I mentioned before, we also make some payments to our shareholders in the form of dividends. If there's extra cash, that goes on to the balance sheet. Take the cash that's currently on the balance sheet and any that gets added, and the first priority, and the second priority, and the third priority of that cash is our acquisition strategy. We want to use that cash to grow our business beyond what we have today, and that's really what we want to use it for.

Have we repurchased shares in the past? We have on a couple of occasions. We do it very opportunistically, but we do not have that as a main tenet for the cash on the balance sheet. We're not somebody who's buying shares back because we have cash. We're not somebody who's buying shares back because it's a consistent program. We will do it, but we will do it on a very rare occasion, and we'll do it very opportunistically. We think we've shown that in the past.

I talked about our dividends. Our dividends for a number of years were quite low. It was down at $0.08 per share. We increased that over about a four-year period more than fourfold, to $0.36 per share. Again, a yield of just under 2%. Our expectation going forward is we might see the dividend increase in the future, but I wouldn't see the type of step functions that we've seen over the past three or four years. I would see more of a steady kind of an increase, should we increase the dividends.

Our shareholder base has increased to about 75% to 80% institutional shareholders. We have very loyal shareholders, and I very much appreciate that. We speak to our shareholders very often. This conference is one example, but we speak to shareholders very, very frequently. I can very much assure you if a shareholder gives me a call, they get a call back very quickly.

We think it's important to be open and transparent with our shareholders. When things are good, we want to tell them things are good. When things are not good, we want to tell them things are not good. We want to be honest. We want to be open. We believe that transparency and the integrity of our management team is one of the reasons our shareholders stay with us.

The guidance, this is the guidance that we provided at our earnings call on February 1st for fiscal year '18, around $75 million revenue. You can see the other metrics here. We will provide full-year guidance for fiscal '19 once we announce our earnings at the end of May.

Finally, I have a long list of reasons why we believe this is a company to invest in. We believe in our markets, in the energy markets. We believe we're well-positioned in those markets. We believe we have a great business model that works well, a business model that, even in this what's been probably the worst energy market in the past 40 years, we stayed profitable or we didn't lose money. We believe we're very well-positioned to grow as the markets are recovering, and we believe that we have a team that is focused on meeting our objectives, meeting the objectives of our shareholders, and ultimately in the shorter term and more importantly in the longer term, providing value to our shareholders.

I don't think I have more than a minute or two for questions, but if anybody has a question.

Yes, sir.

Q: What's the nature of our contracts with the Navy?

Jeff Glajch: Sure. Great question. The question was "What's the nature of our contracts with the Navy? Are they fixed price or are they something different?" I'll actually extend that to our commercial contracts. Our commercial contracts and our Navy contracts are all fixed price. One would suggest, does that introduce risk from a procurement standpoint if you have fixed price contract?

The way we manage that risk is when we take an order, whether it's with the Navy or it's a commercial order, very quickly after taking the order, we secure our raw materials. We may not know exactly what we need, but we have a pretty darn good idea. We may need a ton of stainless steel or a ton of nickel or a little bit more, we will lock those down at the time of taking that order. So then our variable, our risk becomes how we manage that and how we execute on that. We have found over many, many years of history that we execute very well. We actually tend to see gross margin improvements because of how we execute our contracts.

Yes?

Q: What kind of criteria are you using for your acquisitions and specifically talk about referencing your last acquisition that you made in the nuclear power market?

Jeff Glajch: Sure. Okay. The question was what kind of criteria are we using for our acquisitions, specifically talking about referencing our last acquisition that we made the nuclear power market. On that particular acquisition we made that seven years ago, and it did quite well for quite a number of years. It hasn't done as well the last couple of years. So it's unfortunate some of the things that have occurred in the nuclear market, out of our control, but that doesn't forgive us for making that acquisition. We did well for quite a while, and now we're in a little bit of a rough spot.

As we look at acquisitions going forward, we think of them in a couple of ways. We certainly can look at any of our core markets, refining, petrochem, Navy or other military work, as well as nuclear, but probably less likely in nuclear. We want to expand our position, whether it's expanding in the aftermarket there or expanding our product offering to our customers. That's one certain avenue we could consider. Another avenue we have looked at and we will continue to consider is other markets that are perhaps ancillary to what we do.

We're not going to move far away from what we do, but for example what would be an ancillary market? Natural gas would be an ancillary market. We'd benefit from natural gas in the petrochem arena, but we don't play in natural gas.

What else might be an ancillary market? We're in refining in the oil market. We're not in the mid-stream or upstream, that would be an ancillary market. There are a number of ancillary markets that we could play in, but we want to stick close to what we currently do. We will absolutely make sure that it's a market that we believe we can take whatever company we buy and grow it substantially. We're not trying to buy earnings, we're trying to buy earnings with growth attached to it.

I think I'm out of time. Thank you very much. If you anyone has any follow-up questions, you know where to get me. Thank you.