Jim Lines: Hi, good afternoon. I'm Jim Lines of Graham Corporation. With me is Jeff Glajch our CFO. We're pleased to be here this afternoon at this conference. Just to remind you, we do have a Safe Harbor statement, because we will be making forward-looking statements. Pay attention to the cautionary remarks in our forward-looking statement.

Graham Corporation, we provide engineered-to-order custom fabricated equipment but we consider ourselves more than an equipment provider, we are a solutions provider. The key markets that we serve include crude oil refining, chemicals and petrochemicals, the electrical power generation market, and the U.S. Navy. Our fiscal year ends March 31. For the fiscal year that ended a couple months back, revenues were just under $80 million, at $77.5 million. You can see the weighting is roughly 30% refining, 30% chemical industries, 30% Navy and other markets, and 14% was in our power generating markets.

We trade on the New York Stock Exchange. Our current market capitalization is $250 million with just under 10 million shares outstanding. Our institutional ownership is approximately 80% today and just under 3% of our shares are held by insiders.

The applications in the markets that we focus on are where performance of our equipment is paramount. The cost of failure for one of our products is extreme. Our customers have very low tolerance for any performance shortfall. Also, our equipment is typically very difficult to replace, to change out. We have a low relative cost to the overall cost of a refinery or a naval vessel or a petrochemical plant.

In these areas, we find that we can create a lot of value for the users of our equipment and in exchange, we can extract a lot of value from the marketplace in terms of the margin profile of our business and the profitability of the equipment that we sell. We have four key differentiators in our business model.

One is our selling platform, how we sell. The integration of our equipment into our customer's process is complicated. They need help trying to understand how best to accomplish what they're trying to accomplish. We have a very strong sales engineering organization where our engineers are interacting with our customers' engineers to make sure they understand the OpEx-CapEx tradeoff and how best to integrate our equipment into their process, enabling them to meet their operating objectives. We do that at no cost. We provide that service as a value-add service. We expect to be rewarded in one of three ways. One, we get an order that can at times be sole-sourced. Other times we get an order preferentially at a high margin. Or thirdly, perhaps we get the last look at the price they're willing to pay. So that's a very important element of our value driver as it relates to serving our customers.

Secondly, this can be a rite of passage for some of the contracts that we get. These are very complicated order management projects. About half of the order cycle is in our office, doing contract management, administrative functions, detailed engineering. The other half of the contract execution cycle is fabrication. In many cases, our customers are evaluating our infrastructure, our ability to execute their orders through our office, through our technical staff, through our design staff, our quality assurance staff and that can become a rite of passage for a supplier such as Graham. If you don't have that capability, you might have the right price, but you won't be able to execute the order to the customer's satisfaction. Therefore, you're not considered for a project. So it's a very important element. Again, another value driver for Graham and the markets that we've elected to serve as not all industrial companies would have that type of infrastructure in their business, because there is a cost for that.

We're not a typical industrial from an operating model standpoint. We're what is referred to as a low volume, high mix operating model. As opposed to building a highly engineered standard product in a high volume manufacturing environment, we build custom equipment. Each one is unique. Typically, there's no similarity between our products. Therefore, we have a particular model that's been fine tuned for that type of high-mix, high-variability, low-volume environment. Because of the custom nature of what we do, it's not uncommon that when we are in production, our customers are still evolving and modifying the design. Again, a typical industrial company that has a lean manufacturing operations model would be challenged by this type of product. That type of operations model would not serve our end markets well. So this is where we tend to play, where a high degree of customization is necessary.

Then, we're really amazingly expert at building massive weldments with exotic alloys to incredibly tight, watch-type tolerances. Our customers want fabrication dimensions to within hundreths, or thousanths, of an inch on something that's the size of a house. We have the capability and a proven knowhow to do that, and again, not every company has that capability. So, those are the four key differentiators of Graham in the markets that we've chosen to serve.

We segment our business a couple different ways. One is by order size. Our larger project work is about two-thirds of our revenue. Those orders, typically, are between $250,000 to as high as $30 million. The $30 million orders are rather rare. Our average order size is between $250,000 and $2 million or $3 million. As we look at the business across the whole, the average selling price of a large order is approximately $800,000. The lead time, order to shipment, is between 9 months to 18 months, although our naval contracts can have a two to five-year schedule.

The short cycle side of our business, the other one-third of our revenue, can come in and out in a week, in a month, or within one or two quarters. Those are typically smaller in size. The average selling price is under $10,000 and those range between $500 and $250,000. Again, two-thirds of our business is customized projects. There can be some order volatility there. The short cycle side of our business is more predictable and more steady.

The end markets we mentioned earlier that we address, there can be different key drivers within each of those end markets. Crude oil refining, as an example, there are three key drivers that create demand for us. One, of course, is new capacity. That's more of an international story, as opposed to a domestic story. Next, leveraging the installed base to get more out of the installed equipment with revamps or retrofits is a very strong driver for us, of equal weighting and equal importance as the new capacity in the refining sector. We've been in business for over 80 years, so we have a massive installed base of equipment. Refining, in particular, provides a very strong pull for aftermarket, spares and replacements. So there are three demand drivers across refining of equal importance.

In the chemical / petrochemical sector, which is about one-third of our sales on average, more significant there, is new capacity. There's not as much revamp and retrofit, but also spare parts is a key driver there because these plants run for 20, 30, 40 years and the equipment can have wear, corrosion or erosion that comes into play.

The U.S. naval market, which is 15% to 25% of our sales, is typically a new capacity story. There's not much there related to revamping existing vessels and there's very little pertaining to replacement equipment and spare parts.

In the electrical power market, there's more revamp, retrofit, and spare parts elements that are significant; less so, new capacity. You can see there are different drivers and there are multiple drivers within each end market.

Fortunately, we're in the early signs of a recovery in our chemical and refining markets, just coming off of a couple years of a downturn. Anyone following the energy markets would recognize they do have a cyclical nature. We're coming off the back end of about a 3 to 3.5 year downturn. We're now seeing some resurgence in the North American refining market, as is evidenced by the level of our bookings in the last two quarters.

We feel that 2018 was the cycle bottom for this particular downturn. In particular, the second and third quarters were actually the two worst quarters. The fourth quarter showed some positivity. As we look at our business and think about our business over a cycle, we're focused on expanding the size of our business, topline growth, growing Graham. Operating our businesses efficiently is measured by EBITDA margin. Thinking about a cycle average of more than 17%. We have delivered at the top of a cycle, mid-20s. We have achieved bottom of the cycle, high-single digits to low-double digits. Being efficient with our balance sheet, and having a return on invested capital, as a performance measure, that's above 12% over a cycle.

As I said, our markets have begun to turnaround. Our backlog has begun to expand. We had a record level backlog at fiscal year-end, March 31, 2018, of $118 million. The backlog mix is over 50% from our naval strategy, about 30% is in the crude oil refining space, and 5% each in power, chem/petrochem, and our other markets. What's really nice about Graham as an industrial, we do have a long lived backlog, which gives us, as a management team, great visibility for the asset base loading of our operations. Right now, of that record backlog, 55% to 60% is planned to convert over the next 12 months. The other 40% to 45% is in year two, year three, or beyond. So we have a very good visibility into a decent loading of our asset base. That's a wonderful management tool that gives us an ability to adjust well in advance of an issue arising, because of how we can think about our bid pipeline, how we can think about the quality of our backlog, and the size of our backlog.

We have been investing in Graham across this downturn. We're always focused on continuous improvement. We've been working on lead time reduction across our different product lines. We have demonstrated that we've been able to reduce lead times between 20% and 35%, depending upon the product, over the last two or three years. That does improve profitability and drive greater customer satisfaction or customer value.

We're investing in quality. Get it right the first time, each time, every time. We're seeing that show up as a reduction in our non-conformances. That helps with lead time. That helps with profitability. That helps with customer satisfaction and customer value. So across the business, in a number of different ways, we've been investing in ourselves. Even though this has been a very harsh downturn, we didn't just try to weather the downturn. We made sure we focused on preparing Graham to come out of the downturn a stronger company, to be able to take share, to grow sharply, and made sure we did the right things in the downturn to change the slope of our growth as we come out of the downturn.

We do have an acquisition strategy. We're a financially stronger company. We're looking to diversify the products that we offer, the markets that we serve, and also our geographic presence. We want to stick to our knitting around engineered-to-order products. We also would like to look at companies that have a very strong management team, intent on staying, seeing our vision for how to improve business performance, serve end markets, and attach to our strategy, and stay with us and help us grow their businesses.

The size of the company on a revenue basis, not necessarily a transaction basis, is between $20 million to $60 million, that we've been looking at. We've been looking at sizes below that at times and also above that, but we think this is the right spot for us, is in the $20 million to $60 million range. We have been very disciplined. We've had a couple of acquisitions that have gotten very deep into due diligence. They looked like very good businesses, but ultimately, we had to break away from the process because we didn't feel that we could get the right equity-based return on the investment, that may have been accretive to earnings or certainly accretive at one of our margin lines, but we weren't confident about value creation over the long-term or the revenue growth strategy. So we held to our discipline and our process around an equity-based return on any type of large investment. We've not broken that discipline, even though we have a very healthy balance sheet and we're encouraged to put that to work. We won't break our discipline.

Quick financial overview. This gives you the view of the downturn and how extreme it was. We went from $135 million to the depth of the downturn in the fiscal year that ended March 31, 2018 when revenue was just under $80 million and our EBITDA margin on an adjusted basis was 12%. At $135 million, it was 19%. For the year we're in now, that ends March 31, 2019, our revenue guidance is $90 million to $95 million.

We have a great balance sheet. We've done a really good job to build our cash position even through the downturn. As you can see, we progressively added to our cash position. While we had that headwind of revenue going from $135 million down to just under $80 million, we still generated and added to our balance sheet. Operating cash flow, obviously, was positive. We did invest in ourselves during this period of time. We put in approximately $10 million of capital investment across the downturn. As business managers, we do have performance measures around working capital utilization. We try to keep that somewhere between zero and 10%. To bounce above that for a period of time, that's normally tied to receivables. It might fall below that tied to progress payments, but we've been able to get our business to run well between zero and 10% working capital utilization. Right now it's exceptionally low. That's probably not sustainable. We're somewhere in the mid-single digits, typically.

Putting all this together, we are a strong cash generator. Since this management team has been in place, starting in fiscal 2006, approximately 100% of our net income has either been added to our balance sheet or returned to our shareholders in the form of either dividends or stock repurchases. We do have strong free cash flow generation. We do put it back into our business. It goes onto our balance sheet or to the shareholders in two forms, dividends or opportunistic share repurchases.

To that point, our capital allocation strategy is, with respect to operating cash flow, that's for organic growth, reinvesting in ourselves, and paying a quarterly dividend. Then our balance sheet is more for strategic growth or stock repurchases when there's a stock dislocation in our price. We are intent on maintaining, one might say, an inefficient balance sheet, but with the cyclical nature of our business, we think it's a prudently managed balance sheet while we find the right acquisition, with the right value creation, and the appropriate return.

We are focused on our shareholders. The management team and the board have progressively increased our dividend, from what had been de minimis, to now just under a 2% yield, $0.36 per share on an annualized basis, $0.09 per share quarterly. Last year, we distributed $3.5 million in dividends to the shareholders. We've been out marketing the company and making sure the investors are aware of our story, aware of where we are in the cycle. We've been able to expand institutional ownership and interest in Graham, over a long period of time, to 80% institutional ownership today.

Our guidance for fiscal 2019: topline is expected between $90 million and $95 million; gross margin is expected to range between 24% and 25%; SG&A is expected between $18 million and $18.75 million; and we're modeling our effective tax rate to be between 20% and 22%.

As an investment highlight, I think we're situated in a really nice time. Our markets are beginning to recover. We've been in our territories, in the plants with our customers during the downturn, serving them while they weren't spending any money. We're seeing our bid pipeline begin to expand and the quality of our bidding, also expand. So I think we're situated in a really nice footing for long-term growth, tied to the market fundamentals in our energy markets. We have a fantastic balance sheet that we plan to put to work for growth via inorganic strategies, but we will remain disciplined. Graham is a very strong cash generator and the management team is prudent about putting that cash to work and having an equity-based hurdle before we put our money to work.

With that, Jeff and I would be very pleased to answer any questions that you might have. Thank you.

Q&A

Q: [Question Inaudible]

<u>Jim Lines:</u> I think there will always be volatility, because energy is cyclical. What we're doing to address the volatility is trying to diversify – our naval strategies, our diversification strategy – to be less susceptible to an energy market decline, or refining, or petrochemicals – or our move into electrical power generation. Those are not aligned with the cycles of refining and petrochemicals. With the price of commodities, that can be variable, there will always be a feast or famine in the crude oil refining and the petrochemical markets. I don't see that really changing meaningfully, but we're not going to be victims of that. We're taking action through the diversification strategy and we've also been focused on how we move higher.

We spoke about one-third and two-thirds of our product segmentation, small projects and large projects. We are working on moving that predictable fixed base higher. So that also will dampen the cyclicality with our aftermarket strategies that we have in place, or small project strategies that we have in place, supplemented by diversifying into different end markets and geographic diversification.

So I feel, as we think about our energy markets, they will have that cyclical pattern. Our way of getting up underneath that is diversifying and moving our predictable base to a higher level than it had been in the past. When the current management team took over, our predictable base was about $20 million a year. We think we've now gotten that above $50 million a year. It benefited us during this last downturn, which was a horrific downturn actually. Because we had our diversification strategies, and our predictable base strategies, such that our predictable base was much higher, we got through this downturn in better shape than had we not addressed those things with last cycle.

Q: [Question Inaudible]

<u>Jim Lines:</u> What I feel really proud of, as we had identified six or seven years ago, that acquiring talent was going to be an impediment to growth. What we set about doing was shifting our brand as an employer in our local communities and did a very good job of marketing Graham as a strong employer, a place where employees would like to come and build a career. So as a result of that strategy – we put that in place probably around 2010, 2011 – I don't see that as a problem, because our HR team has rebranded our company. We did a lot of things to really get out into the community, to say we're the right company to come to, whether the position was an engineer, a salesperson, a machinist, or a laborer. We're a smallish company. We have about 350 employees. In the past two quarters, we've added 24 people to our organization and our HR team was able to keep pace with our labor demands at this point. So I haven't seen that as a problem and I think that's partly in response to some things we did differently about six years ago to reshape our brand as an employer. So we could pull the workforce to us and have a stickiness to us. We are perceived differently in our local communities as an employer, versus their other options.

Jeff Glajch: Just one additional point on that. You mentioned weld. That's one of the things that we have internally at Graham is a weld lab. We bring in general laborers and teach them to weld. What our welders do is very, very specialized. It's not what I would called simplistic welding; it's very, very complicated. But we take advantage of the resources we have in-house to develop the individuals, which goes a long way to retaining individuals when they realize that the willingness and eagerness that we have as a company to invest in them, to expand their skill base, and ultimately, we give them better opportunities within the company. So that's another way that we've been able to, not only attract, but ultimately retain, excellent employees.

Jim Lines: Another tag on to that is, hiring is one thing, it's time to proficiency that's most important. At that same time we put in the HR strategy, we also put in a very effective onboarding strategy. When I joined the company, 35 years ago – and it wasn't because of my poor ability – my freshman year was five years long, before I could become a productive member of our engineering organization. We said we can't survive with that. We're going to be growing. We're going to be bring new people in. We need to change that onboarding such that the freshman year is as close to a year as possible.

So our management team, with our onboarding practices, our knowledge transfer, and putting our knowledge into our process, as opposed to in the minds of the more senior folks, we've done many things correctly to bring those new hires, whether as a welder, engineer, a salesperson, or someone in the accounting area, to change that freshman year. We're a complicated business. We do complicated things. You probably hear that from every company, but our freshman year truly was about five years when I joined the company. Today it's around 18 months. There are some cases where it's nine months. Depends upon one's skillset. That's been a markedly different result of being able to grow more quickly as we hire the talent, because time to proficiency is key. We task the managers with how to solve that problem. At the same time, we did the rebranding exercise and it's paid off in a big way for us.

Also, what's most important is that it engages the employee more quickly, because no one wants to be in a training mode for five years, not today. They have different sensibilities, different expectations. So today, we can get them into the value creation mode more quickly and they are more engaged, more satisfied with their position. I've been really pleased that the human resource team, and our management team as a whole, thought about these business risks and then drove those out of our business.

Q: [Question Inaudible]

Jim Lines: Sure. There is a serious issue that we're facing now related to tariffs. I tell the story, not because it's a great story, but the day that tweet went out, within two hours, our input cost for certain commodities went up 18%. That moment, the supply chain changed their pricing. Our process though, is we pushed it out into the marketplace. We have a long sales cycle, so we're constantly refreshing our bids and we have a bid validity that can be relatively short, certainly in times of volatility.

So we pushed that into the marketplace and have an open dialogue with the customer about what's going on. We have not been stunned by that, in terms of, we sold something at X that cost us Y, because we're very contemporary in our costs. Certainly in our large project work, we're constantly updating our costs, because that is volatile. That's been the nature of our estimating model is we're constantly updating our costs. We don't have standard costs, we have real costs in real time.

Q: [Question Inaudible]

Jim Lines: They are all fixed. That's something that I think we do well is controlling that risk of a long-lived fixed-cost contract. We have a good percentage of the selling price being input costs of materials. We have strategies on how to control that risk. Typically, we try to procure as quickly as we can and have our customer fund that cash flow so we can get into the supply chain and lock down our costs. The supply chain team, the ops team, have done a good job managing those types of risks.

Any other questions for us.

Q: [Question Inaudible]

Jim Lines: Two aspects to that. One was, we entered two new markets – the naval market and the electrical power generating market, the nuclear market. We were entering two uncorrelated markets to refining / petrochemicals. Then, within refining and petchem, we have a clearer focus now on the installed base. We have this massive installed base that we'd underleveraged. That's really a strategic asset that we didn't fully value and go after value indifferently.

So in the last couple years, we put in some very clear strategies and have some senior folks held accountable. We're driving our aftermarket strategy, creating more value for our customer, and extracting more value from that segment of our business. That will be less cyclical than our large project work. So again, we're thinking about how to move up that predictable fixed base, which dampens the volatility when the large project work is not there.

Q: [Question Inaudible]

Jeff Glajch: The type of businesses we're looking at, as Jim mentioned earlier, they're in the energy markets, they're in engineered-to-order products. So sticking to our knitting in that regard. The type of companies, typically, we are looking at are smaller private companies that have been successful, perhaps have been limited to be able to grow beyond where they've gotten for one of many reasons – capital structure, risk tolerance, the management team. That's where we think we can bring some capabilities to the table and, ultimately, take a company that is x-size and make it 2x perhaps. So that's really our focus – smaller, generally private companies that have some limitation to them that they can't overcome by themselves, but in coupling with us they could.

Jim Lines: Our process is, we market ourselves as an acquirer. We're not typically, although we will, but we're not predominantly looking at deals through an investment banker. We're developing and cultivating targets that aren't thinking of selling. By having interaction with us, it takes a longer time, but it provides for potentially a richer result than through an auction process.

Q: [Question Inaudible]

Jeff Glajch: Ideally, we want them to stay on. That's part of our acquisition model, is to find a business that is running well. The integration of the back office and other portions are going to be a function of how that business is structured, how that business goes the market, and how much synergy there is. If they're are on a similar ERP system or if they're on something different, we have to look at that on a case-by-case basis.

I think we have time for one more question.

Q: [Question Inaudible]

Jeff Glajch: On acquisition valuations, they're still pretty high. There's a lot of money out there chasing not as many things as there are out there. There are lot of folks who are certainly going down into the lower and mid-market that maybe had not been there before. So that's obviously challenging. As Jim mentioned, our model is, let's find a company that's not for sale, that perhaps we can engage one-on-one, get that out of the public market, and have a more one-on-one type negotiating strategy.

In those situations, very often, we can get a price that's fair to the seller, but also fair to us, as a buyer. That's really the approach we've taken. It's not an easy thing to do. We have a strong individual who's helping us within our organization that we hired a while back, helping us look for those opportunities. The good news is, we don't have to find 50, we have to find one or two or three. Hope we will be successful in doing that. Thank you.

Jim Lines: Thank you. Appreciate your attention.