Operator: Greetings and welcome to the Graham Corporation First Quarter Fiscal Year 2019 Financial Results teleconference. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Karen Howard, Investor Relations for Graham Corporation.

Karen Howard: Thank you, Dana, and good morning, everyone. We appreciate you joining us today to discuss Graham's fiscal 2019 first quarter results. You should have a copy of the news release that was distributed across the wires this morning. 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 on 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 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 Jeff to begin. Jeff?

Jeffrey Glajch: Thank you, Karen, and good morning, everyone. If you could turn to slide 4 of the deck, first quarter had revenue of $29.6 million, which was up 42% compared with the first quarter of last year. However, a portion of that, approximately $3 million of the revenue increase, was due to the adoption of a new revenue recognition standard. So excluding that, our sales were up 27%. While we will not speak in much detail about the revenue recognition standard update, I would suggest that if anyone is interested, there is a very well-written detailed analysis of it in the 10-Q which we'll be filing early next week, and I want to compliment our internal team led by Jennifer Condame, our Chief Accounting Officer, who did all the work internally, and did the write-up that you will see in the 10-Q.

Net income in the quarter was $2.3 million or $0.24 per share. The impact of the revenue recognition standard was only $0.01 per share of that $0.24. It had a very minor impact on the profitability in the quarter. Orders in the quarter were $22 million and our backlog remains strong at nearly $115 million.

If you could turn to slide 5, I'll talk in a little more detail about the quarter. As I mentioned earlier, sales were $29.6 million, up from $20.9 million last year. The split of sales, domestic versus international, over the past couple of years has been two-thirds to three quarters domestic sales. However, in this quarter, domestic sales were only 46%. This was driven by one very large project in Canada, which represented more than a third of the revenue in the quarter. We would not expect this shift to be permanent, but rather we expect a one quarter or two quarter impact related to that particular order.

Gross profit was $7.1 million, up from $4.8 million in the previous year. Our gross profit margin was up 130 basis points. If we remove the revenue recognition adjustments, the gross profit margin actually would have been closer to 26% in the quarter, because the $3 million of incremental revenue was at a very low gross profit margin. EBITDA margin was 11.1% versus 8.3% driven by the stronger gross profit margin, and as I mentioned earlier, earnings per share were $0.24, up from $0.10 last year.

On slide 6, from a cash position standpoint, our cash decreased slightly in the quarter down $1.2 million. This is just due to timing of some working capital and nothing beyond that. We did pay out $900,000 in dividends in the quarter. As you may have noted, last night we announced that we are increasing our quarterly dividend from $0.09 per share to $0.10 per share. So our quarterly dividend will be approximately $1 million per quarter going forward.

Cash on hand at the end of the quarter is $75 million, or $7.66 per share. We continue to look to utilize this cash to find an appropriate acquisition candidate or candidates. We continue to be working very hard in that regard. However, we're also keeping our discipline in place and will not make an acquisition for acquisition's sake, but rather we want to make an acquisition which will add to earnings and the cash flow for our shareholders. Capital expenditures in the quarter were very low at $200,000 relative to our expected capital for the year of $2 million to $2.5 million. Again, this is simply timing and there should be nothing to read beyond that.

With that, I'd like to pass the phone over to Jim Lines to talk more about the outlook for the rest of the year.

James Lines: Thank you, Jeff, and good morning, everyone. Please turn your attention to slide 8. Quarterly revenue continues to reflect improved fundamentals in our oil refining markets. Our first quarter revenue from refining markets was two thirds of total revenue, or just under $20 million. It's important to qualify the refining revenue.

There are two factors that boosted revenue during the quarter. First, as you may recall from prior conference calls, an order with specialized high cost material was secured in our third fiscal quarter of 2018 that now is in its revenue cycle. Due to the high material cost, it of course elevates revenue. If the materials were more standard, revenue would have been several million dollars lower in the quarter.

Secondly, our operations team developed, for that particular order, welding methods, and took other actions that resulted in markedly greater productivity, enabling the production process to require fewer hours, which allowed revenue previously planned for the second quarter to be realized in our first quarter. The revenue benefit realized in the first quarter will lower what had been previously planned revenue for the second quarter, all-in-all a terrific job by our operations team.

Revenue from our other markets was down. However, I view that as more of a timing issue as backlog for those end markets has increased. Revenue in the quarter at $29.6 million, or $3 million less if we exclude, as Jeff has outlined, revenue caused by an accounting standard change, is a terrific start to the year. It sets fiscal 2019 up well for appreciable growth compared to fiscal 2018. As Jeff said, domestic sales were 46% of total. Again, that is somewhat distorted by the high material cost of an order that is for a Canadian oil sands upgrader service. We are currently projecting full year revenue of between $95 million and $105 million.

I now will reference slide 9. There was an easy comparison to the order level one-year earlier, nonetheless orders are up across all key industries. There was good order activity in the quarter for U.S. petrochemicals, a second wave expansion, having won orders for an ethylene plant revamp and for downstream new petrochemical capacity. We also had improvement in order levels from our commercial nuclear market. Bookings were $22 million, down compared to $40 million in the previous two quarters. However, there was a healthy level of high quality orders.

Our trailing 12-month order trend is encouraging at $123 million as of June 30. As we drop off $17.1 million from the second quarter of fiscal 2018, and add in new orders across this current quarter we now are in, we should anticipate the trailing 12 months order trend will continue to increase.

On to slide 10, consolidated backlog remained healthy at $115 million. Our work for the U.S. Navy continues to represent a sizable percentage of the total. On June 30th, Navy backlog was 56% of total. It is important to compare and contrast backlog one year earlier to that up-to-date to illustrate how Graham has accelerated from the bottom of a very severe downturn.

On June 30, 2017, backlog was $73 million with non-Navy backlog being approximately $26 million. On June 30, 2018, backlog is up $42 million overall from one year earlier, and with non-Navy backlog at approximately $50 million it has nearly doubled compared to last year. Importantly, order quality has improved as well resulting in greater backlog with stronger margins. We continue to benefit from an extended backlog where 55% to 60% will convert within the next 12 months. The remainder provides a production base loading for two years or three years onward.

On to slide 11. The positive developments on the order front enable us to modify upward full year revenue guidance. I am pleased to provide the following improved guidance. Revenue is expected to be between $95 million and $105 million. Gross margin will range between 24% and 26%. SG&A spend will be between $18 million and $18.75 million. Full year effective tax rate is projected to be 20% to 22%.

With that, Dana, please open the line for questions. Thank you.

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Joe Mondillo from Sidoti & Company. Please proceed with your question.

Joseph Mondillo: Hi, guys, good morning.

Jeffrey Glajch: Good morning, Joe.

James Lines: Good morning, Joe.

Joseph Mondillo: So I was wondering, I went back and looked at when the last time was that you saw this revenue level and, even if you exclude the $3 million of low margin revenue, last time it was around 2013-2014, and we were at around 30% gross margins, and I don't even think refining was as big of a percentage of the total as it was this quarter. So I'm just wondering how you would characterize the pricing that you saw within the work that you did in this quarter relative to the past, and how you're thinking about your orders and your market going forward regarding pricing and gross margins?

James Lines: Sure. Joe, it's a great question, and thank you for bringing it up, because it does require some clarification. What has pulled down margin in the quarter was the high-cost material order which was rather appreciable. As Jeff had mentioned, about a third of the revenue in the quarter was from that specialized high material content order. That will have a tendency of pulling down gross margin on average and that's what occurred. If we normalize the material content to more traditional types of equipment materials, the margin would have been more reflective of typical margins. But importantly, that was dealing with an order that we got some time back and is running through the revenue cycle now.

What I can say more qualitatively is what's coming into backlog, what's building for future revenue is of superior margin to what has been running through revenue. That's not necessarily in the next quarter, but we're looking out a few quarters forward with the bookings that we've been able to secure and with the quality of those bookings we should begin to see margins move up to a higher level. So I would say, Joe, what you saw in this quarter, while that revenue level was comparable to the revenue level of two years or three years back, the margins were not, it was because of material content, and you don't get the same margin bounce on high material content.

Joseph Mondillo: All right. Great. Then just thinking about the cycle in general, you peaked I think around low 30% range in gross margins in the last peak. Just wondering how you're seeing differences play out with this cycle, and how you think about where your gross margins can go. I know Navy is a little below average, even though operating margin there at the Navy is similar. But let's just take Navy out of the equation, looking at your core business, do you think you can surpass the last peak or the last two peaks we've seen a down trend from 40% two peaks ago to 30% last peak. Just wondering how you think about the cycle and the work that you're getting and pricing, and where you think your gross margins can go in this cycle.

Jeffrey Glajch: There's a lot in that question, so let me try to parse it. The 2015 fiscal year at $135 million with 31% gross margin plus or minus, by no means, were we in full stride of a cycle peak. That was initial pickup coming off of a fairly flat three years in a row. We did not project at that point in time that we were into a strong pricing environment, but it was more mid-level pricing environment. So the gross margins reflected that, even though we had high volume, we didn't have strong pricing power at that point in time. We had strong pricing power in fiscal 2008 and fiscal 2009 where gross margins eclipsed to 40%-41% in both those years. 2015 was nowhere near that, nor are we near that today.

However, if we look at our business going forward and as you cited, the Navy, we would generally extract that as a consolidated result because it does, and we've said this consistently, it will pull down gross margin, the Navy work, because of its material content, the type of contract it is. However, it averages in at the op margin line fine. We would anticipate as we get to the next peak with some strong pricing fundamentals that gross margin on a consolidated basis should be in the low to mid 30% including Navy. Our core work would be stronger of course.

Joseph Mondillo: Okay. Great. Then just, I wondered if you could comment on a couple of your end markets, specifically the orders in chemical processing, I know we saw that press release that you put out, obviously things are starting to heat up there. Just wondering if you could comment on that and how you're seeing the pipeline of projects. Do you think orders continue to ramp up going forward? And then also power gen has been really a weak area of your business, but it seems like we're starting to see some life there, a little bit anyways, I'm wondering if you could provide some color on that.

James Lines: Joe, we do see the chemical industry primarily in North America moving into a second wave of investment. That's not necessarily always going to be new capacity, because we are seeing brownfield investments for revamp, debottlenecking, starting up idle facilities. So we did have a fairly large order in this last quarter, what we would call a revamp, coming from our installed-base, and then we also have some new capacity orders that came in, in this last quarter for new petrochemical capacity. We have a pretty good batch of opportunities in front of us for North American petchem, and also some international petchem that should break over the next couple of quarters. We are seeing directionally an improvement in the petchem market where we expect to see a stronger order environment. It will come down to our ability to capture those orders. We feel strong about some, and we feel some are more risky. But in general, directionally, the petchem market is stronger today than we would say it was 12 months ago.

Regarding the power market, and I think your question related to the nuclear market specifically, for the nuclear market we've seen our backlog expand somewhat. I don't want to diminish the great work that our team has done, but it's coming off of a trough type of backlog level in the nuclear market. Our backlog for the nuclear market compared to about a year ago was up about 50%. So the team has done a good job to turn that around, and get that backlog to a healthier level with the nuclear market.

Regarding our power generation market outside of nuclear, we served principally the renewables market. I would characterize our positioning there as we're more opportunistic, when we see an opportunity for the right order, we go after it aggressively and then tuck that into our backlog. We're not a strong player there across the power market primarily because that has an inferior margin potential relative to the rest of our work. Also the commercial terms can be onerous. So therefore we look at those opportunities situationally and opportunistically, and grab that work when it makes sense.

Joseph Mondillo: Okay. A couple of more questions. I wanted to ask about the tariffs and all this inflation that we're seeing on the material side of things. I know directly, I don't think you're that exposed to it just given how your business model works or whatnot. But I was wondering what you're hearing in terms of your customers and specifically projects that you're looking at selling into, are you concerned at all, or is there any risk of any slowdown in demand as people maybe put calls on certain projects or certain CapEx spending given the uncertainty now, and then just waiting until they have a little more certainty, or are you not really hearing anything like that?

James Lines: Well, it has elevated the cost basis for us, and therefore the purchase price that our customers pay for goods like ours, and everyone is experiencing the same type of issue, once the tariff was tweeted, our input costs for certain commodities went up in one day by 18% to 20%, and that was across the supply chain to our end markets. So it is causing an impact to the cost of the projects for our customers. Having said that though, we haven't seen that affect, at this point, the pace of these projects correlated to a tariff impact. But we are hearing, as the procurement functions of our customers saying, 'too bad, deal with it, get your cost down, we're not paying for it.' So we'll deal with that as we can.

Where it really has an impact, Joe, I would say, more meaningfully is in the international markets where, to a similar degree, our international competitors haven't had a step up in cost, because they use an international supply chain. We use a domestic supply chain, or if we're using an international supply chain, it has a tariff put on it. So therefore the input costs that our competition sees for international work is lower. That's having an effect on our margin potential with international work. That's where I see the biggest issue. Actually, we've met with our Congressmen recently, and we talked about the impact this is having on industrial companies and Graham in particular. He just asked us to put on our national hat, think about the nation and don't think about ourselves, and it is impacting us. But if we think long-term, this will get righted over time, but it's having a short-term impact.

Joseph Mondillo: So just to follow on that last commentary, do you think that gross margins could either see a pause in the expansion that you're seeing in terms of the orders, or even a downturn, considering I would imagine currency is also a competitive disadvantage with the dollar increasing. So dollar Fx increasing, your competitors' costs decreasing, you think you could see maybe a pause in gross margin expansion within the order books?

James Lines: I think where this has an impact in our business is in the chemical sector, petrochemical sector, primarily internationally. But for our refining markets, I'm not judging that this will have a large impact on us. In the petchem market it's actually a nice geographic swing back toward investment in North America, where we will see some international competition in North America, but not of course on every project. So I think through our order selection process and the discernment that we exercise on the type of orders to take and the margins that we'll take those orders at, I think we'll be okay on balance.

Joseph Mondillo: Okay. Then the last question that I wanted to ask was regarding the SG&A. I understand what's going on this year with your SG&A budget. I'm just wondering as we look, just thinking theoretically going into 2020, how are you thinking about that budget? Do you think you potentially could have a complete pause on the hiring at least in the sales department, and you potentially see some attrition to some extent. So maybe we don't see a whole lot of SG&A expansion in 2020, or how are you thinking about that coming off of a 2019 year that we already know is up pretty significantly year-over-year?

Jeffrey Glajch: We're thinking about it at this way. We're expecting at this point in time a multi-year expansion across our markets. We intend to capitalize on that, and we need strong channel management to be able to do that. We don't anticipate that SG&A will increase in proportion to the revenue expansion we're expecting in particular from 2019 to 2020. But in absolute terms it is highly likely that the SG&A spend, and including the S spend, will go up, as we ready our organization to capitalize on the opportunities. Then secondarily we have a richness of long tenured employees, and we need to ready our organization for their eventual departure to do something different. We're bringing in some new talent to ready the organization and to have sales continuity, five years forward as an example. There's a fair amount of time that's necessary to ready an individual so that he or she is ready to go in and sell to our customers with the methods and the strategies that we deploy. So therefore we need to bring these individuals in early, and we haven't found anyone that we've been able to hire away from a competitor or industrial peer that's a plug-and-play; it takes a fair amount of time to get these individuals ready to sell the way we sell, and how we optimize price. So therefore I would anticipate the absolute spend to go up, but not in proportion to the revenue expansion at least across 2020 relative to 2019.

Joseph Mondillo: Okay. If I can squeeze in just one last one also, your backlog declined a little bit in the first quarter, and I know just given with all the press releases that you put out in terms of some of these orders, you have a lot of project work in fiscal 2019 that's going to fall off the backlog. Just wondering what your thoughts are on landing more orders this year, and what you're thinking year-end backlog could look like relative to the strong backlog that we saw entering this fiscal year? Do you think you could at least regain enough orders to sustain where the backlog was entering this year? Do you think there potentially could be some growth or do you think there is a risk that backlog is down year-over-year at the end of this year?

James Lines: I'll start with the third question and I'll give you my judgment. Right now, to land at the mid-point, mid-level of our guidance which is $100 million, we see a robust pipeline of opportunities in our bidding pipeline that we are expecting to close in the next one, two or three quarters. My judgment is we'll continue to build a great backlog and expand our backlog, and we're building on our organization accordingly on that premise. So that's the conviction that I have readying for multi-year growth; multi-year growth would suggest a strong order environment with building backlog.

Jeffrey Glajch: Joe, this is Jeff. If I could just add one more comment. Jim talked in his prepared remarks about how our commercial backlog has doubled over the past 12 months. Our expectation is, Jim has talked about the backlog growing, is that we will see continued growth in our commercial backlog.

Joseph Mondillo: Okay. Great. Well, thank you. I appreciate it.

James Lines: Thanks for your questions, Joe.

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

John S. Sturges: Thank you. Nice quarter, gentlemen. Been a bit of a long one, but it looks like cycles turned. I'm curious, about a couple of years ago you had your own welder training program because you had some difficulty finding trained personnel to meet the demand at that point. It looks like you're going to see similar rise in demand. So I'm just curious how are you handling labor, because it's certainly not gotten easier to hire people these days.

James Lines: Thank you, John. We are seeing a shortage of qualified skilled trades people. However that cannot deter our ability to grow. Therefore we are investing to expand our welding training lab, roughly doubling its capacity from what it had been. We're going to build our own workforce. So we'll be bringing in entry level people. We'll train them the Graham way, we'll get them ready. Even if we hired from the outside, it's very common that an ASME welder from the outside is not accustomed to the type of welding, the out of position and the geometries that we weld with, our large fabrication and large weldments, so therefore there is a long training period as well with a trained person to enter the Graham production organization. So we've looked at this quite simply. We have an ability to grow. There's a strong demand in front of us. We have to build our own workforce. We'll look at both the combination of hiring the skilled talent that's already ready and also building our own workforce through our training programs or educational programs. As I just said, we intend to double the size of our welding training lab, so we can put closer to 10 people through our training program at a time.

John S. Sturges: Excellent. I'm curious, you added capacity with your facility capital expansion several years ago. Is there additional capital spending required, say in the next couple of years, or can you meet it with the current capacity ability?

James Lines: As we look at the roof lines, our Batavia, New York roof line we think is suitable for nominally $150 million to $160 million of run rate. Then our Lapeer, Michigan roof line for the nuclear market, that's suitable for $40 million or $50 million of nuclear work. So put that into context, we think we have ample roofline for some growth for some time. However, I do want to put a caveat out there. We are looking at and having some discussions with the primes to the U.S. Navy, and if we were able to expand our product offering there, it may require a facility expansion for those specialized items that we will build there, but that would only be in the event we secure that incremental type work with the U.S. Navy. All very positive, but that would be the reason why we'd have to have facility CapEx, if we take on incrementally more naval work that wasn't modeled into our facility expansion plan.

John S. Sturges: I'm curious. Would that expansion then be in Graham or would it be in Michigan, I mean Batavia or in Michigan?

James Lines: That would be in Batavia.

John S. Sturges: Okay. Terrific. Thank you very much.

James Lines: Very welcome, John.

Operator: Our next question comes from the line of Jim McIlree from Chardan Capital. Please proceed with your question.

Jim McIlree: Thank you. Can you talk about your operating cash flow expectations for the rest of this year, particularly regarding working capital? There was a fairly large investment in working capital this quarter, I'd like to understand how that flows through for the rest of the year?

Jeffrey Glajch: Sure, Jim. This is Jeff. We expect our operating cash flow to be positive for the year, to be quite strong actually, and we will plan to be paying a dividend off of that. We have our capital investment but we expect to be positive. As we grow, we will see some increase in working capital. If we look at our net working capital as a percentage of sales at the end of this last fiscal year, it was a little over 2%. If I look at it today versus our trailing 12-month sales, it's at about 4% which is still a very, very low level, and the type of level that we typically target. We're typically between 0% and 10% and timing of specific projects can move that in a quarter. But we expect to stay at that low level. So will we see some increase in absolute working capital dollars as we move through this early part of this expansion? Yes. Do we think it will dramatically impact our cash position relative to where it's at? The answer to that is we do not.

Jim McIlree: Okay. Thanks. Can you talk about your expectations for Navy bookings over the next 12 months to 24 months?

James Lines: We would expect over the next 12 months to 24 months, not the next one or two quarters, they have a longer timeframe. While we're actually going to convert a fair amount of our backlog, our vision and expectation over the 24-month period is that we will add, in absolute terms, to our naval backlog and have a higher naval backlog at the end of fiscal 2020 compared to where it is today.

Jim McIlree: But it sounds like there is going to be ebbs and flows, just based on the timing of the delivery and the timing of the quarter.

James Lines: Sure.

Jim McIlree: Okay. Perfect. Great. Thanks a lot.

James Lines: Very welcome.

Operator: Our next question comes from the line of Samantha Doxie from Walthausen & Company. Please proceed with your question.

Samantha Doxie: Good morning, guys. Thanks for taking my question.

James Lines: Good morning, Samantha.

Jeffrey Glajch: Good morning.

Samantha Doxie: My first question is, is there any seasonality to how the bookings come in?

James Lines: Not really. There can be some seasonality to our aftermarket which is a smaller sector of our business in terms of the amount of dollars that are booked. We don't really view ourselves as a seasonal business from a revenue or order intake perspective, although there is some seasonality around when our customers place aftermarket orders.

Samantha Doxie: Okay. Thank you. Then my next question is, could you please tell us what the core competencies are of Graham, and then relate those to what you guys are looking for, and how you're going about looking for a way to put all the capital to use?

James Lines: Sure. We look at ourselves as having a number of key core differentiators, and we look for partners and acquisition targets with similar capabilities. One is the way we go to market, the way we sell, the way we create value for our customer, and then the opportunity management. We provide an immense amount of engineering support to our customers while they are evaluating how to build the new facilities or revamp the existing facilities to integrate our type of products into their projects. There's a knowledge gap that we build with, where sales personnel and application personnel come in and provide technical expertise on how to integrate our products into the process.

As a unique capability, there is a fair amount of expense in our business to be able to do that. However, we create a lot of value and we think we extract a lot of value. That's a key differentiator on our customer facing platform.

The second key differentiator, and a very unique capability, that we have is large project management. We take on very large, very complicated projects with a fixed price, and there are always issues that arise in executing those contracts – the design is not frozen, there is engineering churn, there is engineering iteration. We have a model, that we are very adept at being able to do that complex contract management with engineering change, even when projects are in production. So we are not a high volume low mix business, we're a low volume high mix business. That's a particular operating model, and that's a particular operation and function in the office so we look for businesses with similar capabilities, and not all industrials possess that capability.

A third differentiator is, we build incredibly complicated equipment to watch-like tolerances, very large fabrications that can be the size of a small home, where we're held to thousandths of an inch tolerances on critical dimensions. The capabilities of Graham's production personnel and manufacturing experts to construct these large weldments, to high quality requirements, a lot of interaction with our customer, that is a very unique capability. We have to sell it back and we've looked for businesses that have similar characteristics of specialized custom fabrication to very exacting tolerances, and value is not an option, because the cost of value is severe for the user. And we'd look for again a business with that type of capability.

The fourth is a cultural sensibility of cradle-to-grave support to the customer for what we sell. We have an aftermarket team that provides a great deal of technical support once the equipment is in operation, to understand how to improve performance, how to mitigate operational risk and how to ensure that customers meet their operating objectives and maximize their resources to produce the products we're trying to produce. So there's four key differentiators that are the value drivers for Graham, and how we serve our customers, and we look for complementary cultures and capabilities within the targets that we're looking at.

Samantha Doxie: Okay. Great. I really appreciate all the color. Thank you so much. That's it from me.

James Lines: You're welcome.

Operator: Our next question comes from the line of Bill Baldwin from Baldwin Anthony Securities. Please proceed with your question.

Bill Baldwin: Yeah. Good morning, Jim and Jeff.

Jeffrey Glajch: Good morning, Bill.

James Lines: Good morning, Bill.

Bill Baldwin: Jim, looking at your business longer term, and if you deem that to be competitive in the international arena, if you come to that conclusion, does it make sense to focus M&A activity on trying to identify capabilities overseas that would allow you to be able to offer the same value added proposition there that you do here, based upon your specialized welding etcetera, etcetera?

James Lines: Sure. We have had that in our business planning analysis, and I can just share with you where our sensibilities are right now. There's a very large cycle dynamic, as you know, in the energy markets where there is a strong demand and then there is a steep drop off. What occurs when you have bricks and mortar in international operations is you have a higher fixed cost and a higher breakeven that you have to deal with in a very severe cyclical downturn coming at some point in time. What we've elected to do is use a shared margin model whereby we find fabrication partners, where we don't own the bricks and mortar, but we work with high caliber, high quality fabrication partners that, when the need arises, we put work into their operations for our orders, and therefore we don't have that fixed cost.

Then secondarily what we found through our analysis here is we have to have an operations solution that's suitable for China, which is different than what's suitable for India, which will be different for what's suitable for Southeast Asia. So therefore, we've chosen not to have an operating footprint that's global, simply because it elevates our breakeven and our fixed costs, and we can't endure that in any type of cycle dynamics that the energy markets go through. So we've chosen to show the margin and have a variable cost model.

Bill Baldwin: So if you do, what you're saying is, you can't find qualified welders and training crash people outside the United States to be able to fabricate your equipment to the tolerances required by utilizing that shared model.

James Lines: We have been able to do that. The way we do that is we actually put our personnel there. We're a little bit different from our peers, our competitive peers who might place an order with a fabricator, and don't have the same level of surveillance that we impart. When we put an order into a Chinese company or an Indian company, as an example, or an Asian company, our fabrication and quality specialists are in that facility regularly, and we own it, it's our badge, it's our quality, it has been built to our standards. That's been something that the end-users have noticed. When we do a shared margin model, it is very comparable to a Graham product that's being built, because we make sure our fabrication specialists are there, and they're building to our exact quality standards. We don't produce a product that's of a lower quality standard in a low cost region, that's more customary; we produce it to our quality standards.

Bill Baldwin: Very good. Then once your equipment is installed and up and operating, you service and support that equipment from your United States base?

James Lines: We typically do. We haven't built out a localized performance improvement organization in the international markets. But we do have a fairly large team here at our headquarters in Batavia that will go into Thailand, go into Southeast Asia, go into China, go into India, go into South America and provide performance improvement analysis for a refinery of a petrochemical user. We send them over and they do it there. Long term, we might localize that capability, but that's in our long range planning, after the next one year or two years forward.

Bill Baldwin: All right. Now you find that works effectively for you, that you can support that equipment from the U.S.

James Lines: We have, yes. It's typically a fee based opportunity for us. So therefore we've actually built out our organization. If I thought about where it was five years ago, we probably now have 2.5 times the capacity to provide service in the market than we had five years ago, because we've added to that workforce.

Bill Baldwin: Very good. So it looks like, if need be, you can be dependent either on some international projects through the shared model, that just might not financially pass through Graham like it was on the domestic order, but you can still protect your market share over there and protect your brand internationally.

James Lines: Indeed. Let me just cite some success. If we look at China in particular, we had zero market share in the China refining market for ejector systems up until 2006. We put a strategy in place to penetrate, participate and expand market share in the China refining market for ejector systems, and from 2007 through today for the key application crude vacuum distillation we have somewhere between, we believe, 40% and 50% market share with a shared margin model.

Bill Baldwin: Outstanding.

James Lines: Thank you.

Bill Baldwin: And that's utilizing your experienced sales force to capture that business, and then execute it through the shared model.

James Lines: In this particular case, we did localize and have a subsidiary structure set up in Suzhou, China to actually do the technical selling and the customer-facing side of order management, supported by our techno grads here in the home office, but we have localized a team in China that has about 7 or 8 personnel to serve the China market. That was a clear directional strategy that we go in and take that beachhead. We've been successful, we're now turning our attention to other international markets, and are evaluating deploying a similar concept in other high growth industry regions.

Bill Baldwin: Very good. Well, outstanding job, Jim and Jeff and your team.

James Lines: The team has done a great job. Thank you, Bill.

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

John Bair: Thank you. Good morning, Jim and Jeff. How are you doing?

Jeffrey Glajch: Good, John.

James Lines: Good John. Doing well, how are you?

John Bair: Good. The domestic refining market seems to be running at near full capacity. I'm wondering if you've seen any meaningful uptick in expansion, bidding opportunities there. In other words, these market operators are starting to look to expand their capacity, either add-ons or perhaps even some new greenfield type expansion?

James Lines: We've had a batch of work that's secured or running through our revenue cycle now that I would characterize as those types of debottlenecking capacity increase projects for the North American refining market. We have others in our big pipelines that are potentially going to break over the next year or so. So we have begun to see that as they look to leverage their asset base, get more out of it. But rather than add incremental greenfield capacity, the industry of course is trying to figure out how to get more with what they have and they will do incremental strategic investments around bottom of the barrel conversion, feedstock flexibility. Those are investments that we've done for the last two decades, three decades in the North American refining space, because there hasn't been any new capacity to speak of. That's our home turf. They continue doing their best to get more out of these assets and we'll be there to help them do that.

John Bair: Okay. On the last call I asked about this, but I'll re-ask it again with a little more attention being brought about with the IMO, low sulfur diesel for the tanker market. Just wondering if now there is more attention being paid to that, I've seen some reports that say anywhere from 0.5 million to 1.5 million barrels a day, may not be capable of being refined to meet those standards. So I'm wondering if you're seeing anymore, seeing any increase in your customers or potential customers to address that?

James Lines: I'll be honest with you, Jeff and I get those questions quite regularly, and we haven't had much if any commentary from our end markets about needing to do anything, with the exception of I heard it for the first time within the last two weeks of a refiner doing an investment, correlated to MARPOL standards or IMO standards. So we haven't really noticed an uptick that we'd correlate to the type, lower pollution standards for bunker fuels with marine vessels. However, I have heard the remark once from one of our refiners for a project that we're working on.

John Bair: Okay. Very good, good quarter. Congratulations and thanks for the dividend increase.

James Lines: You're very welcome. Thank you.

Jeffrey Glajch: Thank you, John.

Operator: Ladies and gentlemen, we have reached the end of our question-and-answer session. I would like to turn the call back to management for closing remarks.

James Lines: Thank you, Dana. Thank you everyone for your time on the call this morning. We're pleased to update you on our progress as we've entered into fiscal 2019, and also to update our guidance to reflect a stronger outlook that we have for the year. Jeff and I look forward to updating you on the next conference call in one more quarter. Thanks again. Have a good weekend.

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.