

**Operator:** Greetings, and welcome to the Graham Corporation First Quarter Fiscal Year 2020 Financial Results. 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 our host, Karen Howard, Investor Relations for Graham Corporation. Thank you. You may begin.

**Karen Howard:** Thank you, Diego, and good morning everyone. We appreciate you joining us today to discuss Graham's fiscal 2020 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 do not have the release or the slides, you can find them on the company's website at [www.graham-mfg.com](http://www.graham-mfg.com).

On the call with me today are Jim Lines, our President and Chief Executive Officer; and Jeff Glajch, our Chief Financial Officer. Jim and Jeff will review the results for the period, as well as our outlook. We will then open the lines for Q&A.

As you are aware, we may make some forward-looking statements during this discussion, as well as during the Q&A. These statements apply to future events and are subject to risks and uncertainties, as well as other factors, which could cause actual results to differ materially from what is stated on the call. These risks and uncertainties and other factors are provided in the earnings release and in the slide deck, as well as with other documents filed by the Company with the Securities and Exchange Commission. These documents can be found on our website or at [www.sec.gov](http://www.sec.gov).

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

And with that, it's my pleasure to turn the call over to Jeff to begin. Jeff?

**Jeffrey Glajch:** Thank you, Karen, and good morning, everyone. If I could have you turn to slide 4. I want to start out my remarks by noting that we completed the divestiture of our commercial nuclear utility business, Energy Steel, in late June. Energy Steel's results are in the first quarter, but I want to focus on the ongoing business, so I will note when I include or exclude the Energy Steel numbers.

Q1 sales were \$20.6 million, down from \$29.6 million last year. The first quarter of last year had a very large Canadian oil sands refining project, which used high-cost raw materials and hence it was higher than a typical contribution to revenue. That project alone was over one-third of sales in Q1 last year. Within the first quarter revenue, there was \$1.3 million of sales related to Energy Steel and \$2.9 million of sales in last year's first quarter.

Q1 net income was \$82,000 or \$0.01 per share. In Q1, we incurred a \$900,000 loss related to Energy Steel, split fairly evenly between operating results in the quarter and losses related to the divestiture.

Orders in the quarter were \$15 million, \$3 million of which were for Energy Steel. Backlog at the end of Q1 was \$117.2 million. This is down from \$132 million at the end of March. However, over half the reduction was due to pulling out the Energy Steel backlog, which was \$8 million on March 31 and \$9.8 million on the day the business was divested.

If you would turn to slide 5, I noted the sales reduction of \$9 million in Q1 on the previous slide. Sales split in Q1 was 70% domestic, 30% international compared with last year's Q1, which was 46% domestic and 54% international. Domestic sales were up \$1 million, but international sales were down \$10 million. The big decrease in international sales was driven by the Canadian oil sands refining project, which I mentioned earlier.

Gross profit in the quarter dropped to \$4.7 million from \$7.1 million, primarily due to lower revenue. EBITDA, EBITDA margin and earnings per share were all impacted by lower sales in the quarter. The adjusted EPS numbers of \$0.10 per share exclude the \$900,000 loss previously noted. \$464,000 of this loss was related to the operating results of Energy Steel in the quarter, and \$436,000 was related to the divestiture. Last year's net loss from operations for Energy Steel was \$400,000 and is also adjusted out of the numbers shown on slide 5.

If you move to slide 6, our cash position in the quarter decreased by \$5.2 million to \$72.6 million or \$7.34 per share. Nearly all of this reduction was due to timing of accounts payable, and we expect cash to be increasing throughout the rest of fiscal 2020. We paid \$1 million of dividends in the quarter and I want to note that, while our dividend was not announced yesterday per our normal cycle, please do not read anything into this. Our full board will meet on August 7 in conjunction with our Annual Meeting and the quarterly dividend will be considered at that time, as it always is when the full board is present.

Capital spending was light in Q1 at \$300,000. We still expect capital to be in the \$2.5 million to \$2.8 million range in fiscal 2020. Our business development, management team and board continue to be focused on utilizing our strong balance sheet to opportunistically identify and close on acquisitions which have near and long-term benefit to our shareholders. Jim will now complete our presentation on Q1, comment on our outlook and our increased guidance for fiscal 2020.

**James Lines:** Thank you, Jeff. Good morning, everyone. Thank you for joining our first quarter results conference call.

My remarks begin on slide 8. Revenue in the quarter was comparable between our refining and chemical/petrochemical end markets. Revenue to refining end markets was \$7.5 million in the quarter and to chemical/petrochemical end markets, it was \$7.1 million.

Compared to the same quarter last year, refining end market revenue was down approximately \$12 million. This is due, as Jeff had highlighted, to a large Canadian oil sands metallurgical upgrade order in last year's quarter that skewed the year-over-year comparison. There was a percentage of that order in the second quarter of last year, however, it will not skew the year-over-year comparison to the same extent as in the first quarter.

Revenue to chemical/petrochemical end markets was up \$4 million compared to last year. Power industry sales, which includes sales to the commercial nuclear utility market were down \$1.7 million compared to last year. Sales to other end markets, including defense, were up \$900,000 from a year earlier.

We continue to have strong domestic weighting to our sales. Domestic revenue represented 70% of total revenue, and is up 7% from a year ago to \$14.4 million. International sales were down nearly \$10 million from a year earlier to \$6.2 million, due to the previously noted Canadian oil sands order.

Full-year revenue is expected to fall between \$100 million and \$105 million. This excludes revenue from the commercial nuclear utility business. On a comparable basis, fiscal 2019

revenue excluding the commercial nuclear utility business was \$83.6 million. Therefore, on a comparable basis, we expect 20% to 26% top line growth.

Please turn your attention now to slide 9. The bidding pipeline is strong and active. Order timing for large projects remains difficult to predict. A couple of large project bids fell out of the first quarter and we expect to close them in the second quarter.

Nonetheless, the strength of orders from our refining and chemical and petrochemical end markets is evident from the black line in the graph. On a trailing 12 month basis, orders are up nearly 100% from the corporation's non-Navy end market and also excluding those for the commercial nuclear utility market compared to the inflection point, or cycle bottom for orders, that was the second quarter of fiscal 2018.

While difficult to predict, we do expect an uptick in orders in our second quarter, compared to \$15.1 million in the first quarter. We do have a substantial pipeline of bids for refining and chemical/petrochemical end markets where vendor award is anticipated within fiscal 2020. I mentioned on a previous slide the top line for fiscal 2020 is projected to be between \$100 million and \$105 million, and we also project full-year book-to-bill to be above 1.0, setting up fiscal 2021 to be another growth year for the corporation.

I'm now referring to slide 10. Backlog on June 30 stood at \$117.2 million and was lowered by \$9.8 million due to the sale of our commercial nuclear utility business. 54% of backlog is for the U.S. Navy and spans three nuclear propulsion vessel programs, two classes of submarine and the aircraft carrier program.

It is important to point out that we are committed to the naval nuclear propulsion program that represents 54% of our backlog. We continue to invest resources to grow revenue and market share in this end market. Customers, the execution model, end market fundamentals and our growth investments for the naval nuclear propulsion program are distinctly different and not at all related to the commercial nuclear utility market, which we sold in June.

Backlog to the refining industry was 21% of total backlog, as is backlog for chemical and petrochemical end markets. We expect that 55% to 60% of backlog will convert during the next 12 months and 25% to 35% is longer-lived that doesn't begin to convert into revenue until two years and beyond.

Please now move on to slide 11. We are modifying upward our revenue and margin guidance. We anticipate, as noted previously, that revenue for fiscal 2020 will fall between \$100 million and \$105 million. This represents 20% to 26% top line growth, excluding the commercial nuclear utility business. Gross margin is expected to be between 24% and 26%. SG&A spend is projected to be \$17 million to \$18 million, and our effective tax rate is approximately 20%. Achieving the upper end of the revenue guidance will be influenced by orders we anticipate to close in the second quarter and current backlog conversion. Also short-cycle revenue holding at the current run rate is implicit in the top line guidance.

Diego, please open the line now for questions. Thank you.

**Operator:** Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Theodore O'Neill with Litchfield Hills Research. Please state your question.

**Theodore O'Neill:** Thanks very much. Thanks for the good outlook for the year. The question I have for you, Jim and Jeff, is, talking to customers, looking at the softness in orders in the

quarter, is any of this related to either weather or shifting views on tariffs coming out of the United States?

**James Lines:** Hi, Theo. Good morning, this is Jim.

**Theodore O'Neill:** Good morning.

**James Lines:** No, we really didn't identify anything that was correlated to weather or trade policy, specifically the tariffs. What we have seen is, in one case it was a very protracted negotiation once the customer set their side to finalize the purchase order, it took about four weeks to settle commercial terms and delivery schedule and everything else that accompanies a complex purchase order. We were able to land that order in July, but it fell out of the June quarter in that particular case. And another case, it was just the pace at which Latin American transactions can move, and they can move at their own pace, but we are seeing that one shift from the first quarter to the second quarter. In the case of that particular order, we feel very good that it should close in the second quarter. So nothing related to tariffs, nothing related to weather, just the pace at which these transactions at times can take to come to closure. It's very difficult to predict.

**Theodore O'Neill:** Yeah. So it's just a matter of it falling from one quarter into the next quarter, we're slipping into Q2 in some cases.

**James Lines:** In the cases that I cited. One, we've been able to close and then the other we're still in the hunt for it, but we're expecting it to close in the quarter, of the two that we felt would close last quarter that did not.

**Theodore O'Neill:** Okay. Thanks very much.

**James Lines:** You're welcome. Thanks for your question.

**Operator:** Our next question comes from Joe Mondillo with Sidoti & Company. Please state your question.

**Joseph Mondillo:** Hi, guys.

**James Lines:** Good morning, Joe.

**Joseph Mondillo:** Good morning. So wanted to address the guidance first off. So you even mentioned that it suggests a pickup in the second half. And I'm wondering what market of your three main buckets – oil refining, petrochem and Navy – where is most of that coming from or is it broad-based?

**James Lines:** Looking at our backlog conversion, there's a large uptick in the second half that will be for the refining end market and also a strong revenue level from chemical/petrochemical. And also compared with the first quarter, we would expect for the naval end market revenue in the second half quarter-by-quarter to be stronger than the first quarter. So pretty well spread out.

**Joseph Mondillo:** Okay. And so that's relative to your backlog and what you can see, and I understand that you have the visibility for that. The one thing that I was wondering if you were going to recognize and book pretty good pickup in revenue, you also pointed out that you're anticipating a book-to-bill ratio above 1. In the first quarter it was below 1. And so, you also mentioned in your prepared remarks that your pipeline is pretty strong. What gives you the confidence though, that you're going to be able to see a pretty good pickup in orders?

**James Lines:** The maturity of the bids in our pipeline and our understanding of the timing, while it's been difficult quarter-to-quarter, we have three quarters to pull these in. And in some cases, we've been in the hunt now for over a year for some of these projects. In one case, it's been over five years. So we have a pretty good view of the basket of opportunities. And we don't expect to get them all, but there are enough opportunities with a closing horizon of being fiscal 2020 that we have the confidence level to come out and get in front of it now, that book-to-bill will be above 1. And then further supplemented by our timing expectations for some new naval orders in the year. So we're expecting to add to our naval backlog and those have months in which they can slide, but typically, not multiple quarters. So we do have a good view that the book-to-bill should be above 1, for the reasons that I just cited.

**Joseph Mondillo:** Okay.

**Jeffrey Glajch:** This is Jeff. Joe, I'd like to just add one additional thought on those – regarding the revenue in the second half of the year, the projects have a relatively tightly defined delivery date. So while they have slipped a little bit on the order side, the ones that we're expecting to come through in the near-term that will ultimately impact the second half of the year, the delivery can't slip because of the customer timing. So that gives us a high level of confidence on the revenue timing in the second half of the year, in Q3 and Q4.

**Joseph Mondillo:** Okay. I understand. My last question is just regarding the acquisition process and how that's going, and the balance sheet and everything. I wonder if you could give just a broad update on that? And then if you could also address your process, in terms of trying to find acquisitions and going about that, and the acquisition strategy overall and whether that has changed versus when you acquired Energy Steel. Just curious on how that's evolved over the last 10 years.

**Jeffrey Glajch:** Sure. On your first question, Joe, the opportunities in our pipeline are pretty strong – are quite strong actually. We're focused on opportunities in the naval market. We're focused on aftermarket or non-large capital opportunities in the commercial market. And all of those areas are looking strong. We continue to have a number of opportunities directly in front of us. But as you know from the past, you have to get one over the goal line. And to get one over the goal line you've got to go through quite a lot of due diligence.

Regarding your second question which was, how has our process changed? I would say the process hasn't changed a lot. But I think there is a key addition to it which has improved our capabilities. That is, that we brought in a Director of Business Development a few years ago who has done a great job of really expanding that pipeline and expanding our access points. In the past, it was a part-time job for a small number of us here and we would certainly use external advisors. We continue to use external advisors, but with our Director of Business Development, Chris Johnston, onboard he's done a great job of really building that pipeline up. The internal pipeline that he's driven and the number of opportunities, the breadth of opportunities today, are far greater than they were at any point in the past.

**James Lines:** Joe, I just want to also add, part of our process improvement, if you will, following the Energy Steel acquisition, is as we look at the businesses and the end market fundamentals and the potential volatility in those end markets, we have a scenario analysis to analyze the business cost as flexible cost and what happens in an unexpected collapse of the end market; and how can that business look if revenue went down 15%, 20%, 25%, 40% as we experienced with Energy Steel; and how flexible might cost bases be for that business to survive in an end market collapse such as we experienced with Energy Steel and the nuclear

utility market. And some markets may not have that variability, but that's part of our scenario analysis and analysis of the business and what we might do under the what-if scenarios.

**Operator:** Thank you. Our next question comes from Bill Baldwin with Baldwin Anthony Securities. Please state your question.

**Bill Baldwin:** Hey. Good morning, Jim and Jeff.

**James Lines:** Good morning, Bill.

**Bill Baldwin:** Congratulations on the hard work. And looks like it's beginning to really pay off for you.

**James Lines:** Thank you, Bill.

**Bill Baldwin:** I just want to ask you, on the \$15.1 million in order flow, can you break that down for us between the end markets of your business, the chemical, refinery, Navy and power?

**James Lines:** It was, obviously, a light order level. So we had our typical run rate for what we call our short cycle work which goes across a lot of end markets with the exception of Navy. We had not much from the Navy on the large project side. So it was mostly refining and chemicals.

**Jeffrey Glajch:** And, Bill, I did note in our call that \$3 million of that was the commercial nuclear utility business which, of course, we don't have any more. So the core refining and petrochem markets were the remaining – essentially all or most of the remaining \$12 million.

**Bill Baldwin:** Okay. And on your short cycle business, I'm sure you described before, but please refresh me. What's generally the nature of that business? What types of services and products are involved with your short cycle business? And I assume short cycle is what, just less than 12 months, not less than 12 months?

**James Lines:** To fit into that distinction, it typically comes in and out within a week to two quarters.

**Bill Baldwin:** Okay.

**James Lines:** That is what normally fits inside that work. So they are less transactional in nature in terms of how complex of a process they are. A large percentage of that is spare parts and in-kind replacements that make up the short cycle work. And then also we have some smaller products, a product that is less engineered-to-order and they tend to come in and out in three months. So it can be new product sales and it also can be replacements, spare parts and services like that.

**Bill Baldwin:** And primarily going into the refinery and petrochemical markets?

**James Lines:** On the aftermarket segment, it's largely refining and chemical and petrochemical end markets. For the new products, it can go across all industries; general industrial, also refining and petchem, pharmaceutical, some cannabis. We sell into the cannabis end market, as an example.

**Bill Baldwin:** So, for equipment in the aftermarket business, the drivers, I guess, are equipment utilization and then just length of time the installation has been installed, how long it's been out there.

**James Lines:** You're right. We're very fortunate in that we're an 80-year-old business. We have a massive installed base in North America as well as around the world that drives a pretty steady drumbeat for aftermarket. And we're not being passive there either. We've made some

investments in the organizational structure and the location of personnel where the installed base is high where, over time, we're intending to drive the aftermarket segment of our work to higher levels than it had been historically by getting closer to the end user, providing our services to help them improve operational reliability and to forecast time to replace the equipment better. And that, we believe, will really pay off in affiliation that the customer has with Graham, but also improving our revenue and profitability from that segment of our business.

**Bill Baldwin:** Absolutely. Do you all – if you do, I have missed it. Do you all break out or give some indication of what part of your revenues, historically, are generated from the aftermarket?

**James Lines:** Over the years, we've been on and off, no intended purpose for being on or off. But if I cite in the past what we had said, our aftermarket parts and replacements were in the order of 20% of revenue. But what had been missed when we did a deeper dive, so much of our work, because of the installed base is coming from revamp, debottleneck and larger project work. So, in total, we tend to think of Graham's revenue being somewhere between 30% to 40% derived from our installed base. It could be a revamp, it could be debottleneck, large project work, but it's from our installed base. So replacing somebody else's equipment, and then also the classic parts and replacements. So it's more akin to one-third plus or minus of our revenue is derived from that, from the installed base.

**Bill Baldwin:** And that would be calculated using probably over a complete cycle right, averaged over a period of time?

**James Lines:** Yes. We tend to look at things in 5-year or 10-year snapshots.

**Bill Baldwin:** Jim, based on the fact that your work is so specialized and has your engineering content and so forth, does that mean that competitors have a very difficult time going into your installed base and trying to take that aftermarket business away from you?

**James Lines:** Yes. We think that's a pretty high moat, because we don't disclose the details of our designs, and it's difficult for us to actually go in and dissect our competitor's installations. It can be done, but it's hard. So typically it's a complete replacement when you're going into a competitor's equipment as opposed to a partial replacement.

**Bill Baldwin:** Right.

**James Lines:** Some of our systems have five, six, seven components put together to work. And it's very difficult to go in or have a competitor go in and replace component three, seven and six and guarantee the overall system. The OEM is best suited to do that.

**Bill Baldwin:** Very good. It sounds like that puts you in a really good position to really get benefits from this focus that you're putting on in the aftermarket.

**James Lines:** We think so.

**Bill Baldwin:** Good luck. Good success.

**James Lines:** We assembled a great team. They're doing a great job for us.

**Bill Baldwin:** Thank you.

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

**Operator:** Thank you. [Operator Instructions] Our next question comes from John Bair with Ascend Wealth Advisors. Please state your question.

**John Bair:** Thank you. Good morning, Jim and Jeff.

**Jeffrey Glajch:** Good morning, John.

**James Lines:** Good morning, John.

**John Bair:** Yeah. Hey. Just wondering if you had any loss of backlog as a result of the Philadelphia Energy Solutions refinery fire and shutdown. And if there's any indication that that lost refining capacity might be picked up by other operators or not – my understanding is that's going to be shut down. But another operator refinery in another part of the country might try to pick up that lost capacity.

**James Lines:** Hi, John. To the first question, we can't identify anything that's material with respect to reduction of our backlog tied to Philadelphia Energy Solutions. Nothing meaningful there. On the question of, should that refinery be disabled or shut down and its capacity has to be picked up by other regional refiners or other refiners in North America, that would directionally favor us. But typically, if you look at the refineries, they're running at 90% to 95% utilization. Philadelphia Energy Solutions, as part of the North American refining base, is not meaningful, it's on the lower end of the barrels per day. So we would anticipate that the refining asset base in North America would pick up the slack.

**John Bair:** Yeah. With 335,000 barrels a day, something like that, I believe it was. But just was trying to see if you thought maybe – or had any indication from some of your other customers that maybe that would cause them to look to expand some of their operations whether it's on a regional basis or elsewhere. So I guess your answer is that you don't have any indication that that's the case.

**James Lines:** No, no. They represent about 1.5% of the refining asset base in North America, that number you just cited. So we would anticipate that could be absorbed within the 90% to 95% utilization level that the refiners are running today.

**John Bair:** Okay. Very good. That's all I had for today. Thank you.

**James Lines:** Thank you, John.

**John Bair:** Okay. Bye.

**James Lines:** Yes. Bye.

**Operator:** Thank you. Ladies and gentlemen, there are no further questions at this time. I'll turn it back to management for closing remarks.

**James Lines:** Thank you, Diego, and thank you, everyone for your questions and listening in on our conference call today. We look forward to updating you on our progress at the end of the second quarter. And as we have any meaningful orders we'll endeavor to announce them with press releases as they come in to keep everyone informed on the progress of new orders and backlog build. So thank you very much. Have a good day.

**Operator:** Thank you. This concludes today's conference. Thank you all for your participation. You may disconnect your lines at this time. Have a great day.