Joe Mondillo: Good morning, everyone. We're going to get started. My name is Joe Mondillo, I'm an industrial analyst at Sidoti & Company. I've covered Graham for nine years or so, probably a little more. This morning we have Jim Lines, CEO, as well as Jeff Glajch, CFO, from the Company. They're going to give some information about the Company itself and then we're going to leave some Q&A time at the end. So with that I'll let Jim get started.

Jim Lines: Thank you, Joe, and good morning, everyone.

Slide 4. Let me quickly introduce Graham. We are a micro-cap industrial, principally serving the energy, chemical and defense markets. We provide highly customized, specially fabricated, engineered-to-order products and solutions. How do we go to market? We have a combination of direct sales personnel in different locations around the world and we also go to market through about 50 independent manufacturers representatives, also located globally where we have a concentration of our customers.

Our principle operating entity is in Batavia, New York, between Buffalo and Rochester. And we also partner with global fabrication supply chain partners. Our market cap is nominally $200 million. Most recently we have just under 10 million shares issued. Insider ownership is just over 3% and our institutional ownership is just under 80%. I mentioned our key end markets, our sales mix by end market is fairly evenly split, roughly one-third, one-third, one-third, it can vary a little bit from time to time by demand drivers in the different end markets, but we're roughly split evenly across the three key segments that we spoke about.

Slide 5. What makes Graham unique, or an interesting investment, is that globally we have very strong market positions and an incredibly powerful brand, having been a supplier to these markets for over eight decades. Also unique to us is that our equipment is principally static equipment. It's not rotating parts or instrumentation. We do derive a large amount of revenue from our 80 year history of installed equipment.

Our revenue from the installed base is somewhere between 30% and 40% on an annual basis, which is rather predictable and, of course, that does garner a higher margin than new capacity sales. We have been investing to drive growth in our more predictable revenue streams to take volatility out of our revenue and earnings. We're also looking at acquisitions with our strong balance sheet to do the same, trying to reduce earnings volatility over time. We do, as I said, have a very strong balance sheet that enables us to invest in both organic and inorganic opportunities to expand revenue. Our businesses, if you've watched us over a period of time during a strong up cycle, generate tremendous amounts of cash flow and margin enhancement as revenue expands with the strong operating leverage that we do garner.

Slide 6. Where we play, where we focus, and where we are most valued by our customers is where the applications of critical performance is paramount. Performance shortcoming is unacceptable to our customer whether that customer is the U.S. Navy, a refiner, or a large petrochemical plant. So failure tolerance is actually zero. Additionally, the equipment is very difficult to replace once it's installed. If you think about an aircraft carrier or a submarine or a very large refinery or petrochemical complex, our equipment is not easy to replace.

Relative to the overall cost of a refinery or a chemical plant, our equipment is relatively small in comparison to the total CapEx for the facility. For example, the submarine might be $4 billion, our content could be $20 million to $30 million. And in refining, the refinery may be $10 billion and our content is $20 million to $30 million, so relatively low cost to the overall plant.

Slide 7. We segment our business in a number of different ways. Our large commercial project work is what gets most notoriety. This represents about half of our revenue and has an average selling price somewhere around $800,000, but those projects can range between $250 thousand and $10 million. The order-to-shipment cycle for that type of order is somewhere between nine and 18 months typically.

Our large Navy work, which are typically quite large orders, represents about 15% of our sales today. The conversion cycle for that type of order might be up to five years, depending on how large the order is.

And finally, about a third of our revenue is a quick turn or short cycle commercial work. The average selling price is below around $10 thousand and we tend to get that type of order in and out of the business in a week to a few months, typically under six months.

Slide 8. The way we go-to-market, how we differentiate ourselves, and most importantly how we create value for the buyers of our equipment, is through our consultative selling platform. Our equipment is quite complex. How it integrates into our customers' facilities is very rigorous and requires quite a bit of interaction with our customers where they have to draw upon our knowledge and our knowhow. We spend a lot of time before an order is placed, helping our customer, understanding how best to integrate our equipment into their process. That's a really strong value proposition that we drive and have built into our organization. We feel we get rewarded with margin, selling a differentiated solution at a premium relative to our competition. Or perhaps the worst that happens is, we get the last look at what the buyer's prepared to pay.

We have an organization that's proven its ability to execute complex projects. These are very complex orders where we may have a six to nine months fabrication cycle and we may also have six to nine months in our office for the engineering and the detailed design and the interaction back and forth with our customer. This is a unique capability that not many industrials have. Again, with serving the end markets that we're focused on, it is paramount that we have those essential capabilities.

We have a low volume, high mix operating model where, because of the specialized nature of the work we do, when our work is in production it can still be going through design changes. Therefore we must have an operating model that is adept at having extended delays and changes in fabrication while our customers are finalizing the design they actually want. So that also relates to the way we manage WIP, we have a lot of work in process with the ability to deploy our resources from one contract to another going through execution.

Lastly, one of Graham's unique differentiators is that we build pretty large equipment, as large as this room, where our customers are demanding watch-like tolerances on critical dimensions. We're able to build these massive fabrications in a way that meets that criteria with special metallurgy, special fabrication techniques. Again, not all industrials have these capabilities.

Slide 9. Our Organic growth strategies are really focused on how we take more market share and leverage our installed base. With an 80 year history of providing equipment, we believe, based on looking at our shipments statistics, we have somewhere between $750 million to $1 billion of installed base in North America.

We have opportunities that are originating now at the plant level. We're spending more time structuring our customer-facing organization to be more attune with the activity at the plant as opposed to our engineering procurement and construction contractor centric model. We're going through some modifications to the front end of the business to be closer to the end user at the plant level, to leverage our installed base. As I said earlier, we're getting about a third to 40% of our revenue from our installed base on an annual basis.

Internationally we have a new capacity strategy of leveraging the global fabrication supply chain, localizing some operations with our partners to drive down costs and work within a constrained market price with a different cost basis to be successful and take market share.

Lastly, we are expanding our offering and taking more market share within the U.S. Navy, or the defense segment, as part of our organic growth strategy.

Slide 10. Our different end markets have different drivers. Refineries are dubbed unique in that they have three key drivers for us. One is global new capacity, around 40% of our refinery driver is from new capacity refinery sales. Also, refiners are constantly investing in what's called sustaining capital investment to keep the refineries running, get more throughput through those refineries, and improve the conversion of a barrel of oil to transportation fuels. This is equally important to us as new capacity, believe it or not. There's also a nice spare and replacement market. Somewhere around 25% of the refining business is classic spares and replacements.

In the chemical sector, that's more of a new capacity play, but also with the age of the plants there can be spares and replacements as well. U.S. Navy, is principally new capacity, new vessels. Other end markets are principally new capacity with some significant demand drivers for replacements and spare parts.

Slide 11. I mentioned our focus on stabilizing and reducing the volatility of our revenues and our earnings. We have been on a journey to increase our predictable base of revenue which, when the current management team took over, was somewhere around $20 million of what we would define as predictable, or less volatile revenue. Today that is approaching $50 million with a target to move that higher and above $60 million. We have had very nice progression of dampening the volatility of the cyclical nature on certain of our end markets. This has been a very successful strategy. The Naval campaign fits inside that predictable base business as well.

Slide 12. You could discern, from my remarks earlier about the large project work, that we have order volatility from quarter to quarter. We can have orders that are $3 million, $4 million or $5 million at times, and depending on if one falls in a quarter or moves to a subsequent quarter, or moves a couple of quarters, orders on a quarter-to-quarter basis may be somewhat unpredictable. Because of this we tend to look at orders on a trailing 12 months basis. And importantly, we had a rough downturn that we've come out of in the energy markets that really hit the trough in the second quarter of our fiscal 2018. On an annualized basis, the trailing 12 month bookings for that segment had been about $40 million and today it's about $80 million. So we've begun to see the improvement in our end markets show up in our order pattern. And that's the dark blue line there on the graph.

But again, if you watch Graham, there can be extreme order volatility quarter to quarter. I would just caution you, don't be euphoric if you see a strong quarter and don't necessarily be pessimistic if you see a soft quarter. We will provide guidance through our quarterly conference calls regarding how we see the outlook. Again, don't overreact positively or negatively to what happens on a bookings level in a given quarter.

Slide 13. Coming off of a cycle bottom, we have great operating leverage as we begin to expand revenue and the market fundamentals improve with respect to how that shows up in pricing power. We drop down tremendous margin enhancement as revenue expands. So we've come off the bottom, we had about 25% growth 2018 to 2019, we're forecasting 20-ish percent growth, if we take away the divestiture that we had for the current fiscal year. We believe we are in a multi-year expansion phase with our end markets and this is how we see the dynamics playing out in the defense market and refining and petrochemical markets.

Slide 14. We have very strong high-quality backlog that sits as of the end of June at $117 million. We did divest of our commercial nuclear business in our fiscal 2020 first quarter, so that took about $8 million out of backlog. On a comparable basis to the ongoing business, our backlog has been fairly flat. That backlog is roughly half tied to the U.S. Navy, 20% for refining and 20% to the chemical industry and the remainder relates to our other end markets.

What's been unique across the journey that we've been on, penetrating the Naval Nuclear Propulsion program, is we now have a longer lived backlog. In our past, if you follow Graham probably 2010 and earlier, 90% of our backlog would burn over 12 months typically. Today, our backlog is a multi-year backlog where we are seeing our backlog burn be roughly 55% to 60% in the next 12 months. We have a portion of our backlog now that is long-life backlog. Right now this is about one-third of our backlog that will burn 24 months out. This gives management a very nice predictable base. This is a luxury that we have that we didn't have previously. as a management team.

Slide 15. We are looking for acquisitions to deploy the capital we have on our balance sheet and are thinking in terms of how we strengthen our predictable revenue streams. We are concentrating on businesses in the defense, or Naval, end markets or something associated with the installed base or the aftermarket to maintain that predictable revenue stream. We're looking for businesses that have built out a strong management team where that management team wants to stay with us to see the synergy of working with us, and together doing something more than they can do by themselves.

From a revenue size perspective we are looking for businesses in the $20 million to $60 million revenue range. We have looked above that and a little bit below that but that seems to be our sweet spot. We are looking for the transaction value to be a bit more than that revenue range, and are looking at where the EBITDA multiples are and what the EBITDA of these businesses is. We're not looking for an easy cash-based return. We're looking for an equity-based return and we've been very deliberate. If you follow us on our conference calls, it's a pretty common question that Jeff or I might get, with respect to when are we going to do an acquisition. We've been looking for a number of years, we'll look when the price is right and the strategic fit makes sense. At times we're seeing one or two turns on price, we just can't close that gap. So we've been disciplined not to move too quickly and overpay for something. We just aren't inclined to do that nor would we intend to do that. We don't see any value in that.

Slide 17. As we are going through this expansion and recovery, we are guiding that our current year outlook will be between $100 million and $105 million of revenue. I didn't say this earlier but we are a fiscal year end at March 31. So when we speak of fiscal 2020 that ends March 31, 2020.

Slide 18. The balance sheet qualitatively is very strong. We have about $70 million worth of available cash to put back into investing in organic and inorganic growth. We have strong operating cash flow. We have worked a lot on working capital utilization. A decade or so ago, we were somewhere around 15% to 20% of working capital as a percent of sales. We now tend to be in that 5% range. We have worked hard on how we manage our contracts to be more efficient at working capital utilization. Our capital spending is pretty comparable to depreciation, although we may have periods of time where that steps up. Capital spending this year is targeted to be between $2.5 million and $2.8 million. Depreciation is about $2 million.

Slide 19. I previously mentioned strong cash flow. This is a pictorial of our business across the cycle and even though we had two very extreme downturns during this period of time we have been able to return more than 100% of net income to the balance sheet. That's a pretty unique characteristic of an industrial company like ourselves. While we've invested about $30 million of capital back into the business, we still have been able to return to our shareholders and balance sheet, roughly the net income level. We've used that to return to shareholders through stock repurchases at opportunistic times, and also an ongoing quarterly cash dividend. Again, this was a period of time where we had some pretty tough downturns in 2009 and also in 2015 and 2016.

Slide 20. Our capital allocation priorities are deploying operating cash flow into organic growth, paying dividends, external growth, strategic partnerships and strengthening our revenue. We look at stock repurchases, but not as an ongoing commitment, but we look more opportunistically at when it makes sense. We've done that a couple of times over the years.

Slide 21. We do have a dividend which we've been increasing at different points in time. We're now at $0.44 per share in annualized dividend payments. Last year, we returned just under $4 million in dividends to shareholders.

We are covered by Joe within Sidoti and Joe does a great job for us. We are also covered by two other analysts.

As I cited earlier, the interest that Graham has garnered through the IR program that we have, has resulted in our ability to increase our institutional ownership from roughly one-third of our shares being held by institutions over a decade or so ago to almost 80% today.

Slide 22. The guidance that we have for the fiscal year ending March 31 is for revenue to be between $100 million and $105 million. Gross margin 24% to 26%, SG&A spend between $17 million to $18 million and an effective tax rate of about 20%. And again, from an ongoing business point of view, excluding the divestiture of our nuclear business, that revenue expansion represents 20% to 26% year-over-year from fiscal 2019 to fiscal 2020.

Slide 23. Investment highlights again, we have a very, very powerful global brand that gives us tremendous market access. We are well-known across the globe. We have a massive installed base in North America, but also globally that drives demand. It's a pretty predictable level of business with somewhere above 30% of our sales annually. We've been investing and structuring our business to generate more predictable revenue streams to dampen some of the revenue and earnings volatility that had been on the utility you see of our business. We have a great balance sheet that I just spoke about and as we go into an expansion cycle, which we are in, we generate tremendous cash flow and also have very strong operating leverage as our revenue expands.

With that, I'll be glad to open it up to questions for Jeff and myself.

Question (Inaudible)

Jim Lines: The question is, can we describe more clearly what represents the $60 million of predictable base? That's really in a couple of different components. We have our short cycle work that is relatively predictable. That's our spare parts and some of our aftermarket work and our smaller orders that tend to come in and out in a quarter. That's relatively predictable. That tends to have a variability cycle peak to cycle bottom of 10%-15% whereas large project work can have a variability of 50% to 60%. So that's one of our paths.

Also, once our Naval work is in the backlog, that has a very clear burn rate. We put our Naval revenue into our predictable base because that is a predictable revenue stream. I think we had a slide that showed Navy represents about 15% of revenues. So out of that $100 million, this would be somewhere north of $15 million of revenue from our Naval backlog burn.

And then we have some new equipment orders that are smallish in size, but they are relatively predictable as they don't have the variability of the large project work.

Question (Inaudible)

Jim Lines: Yes, yes. I'm sorry, the question was, is the profitability inherently higher? Answer was yes.

Question (Inaudible)

Jim Lines: The question is, can we break the guidance down by end markets? We are seeing in our 2020 revenue projection for the guidance, a step-up in our Naval revenue from fiscal 2019. We're also seeing expansion in our refining end market as that is beginning to become more favorable, and then also our petchem vertical that's going to be comparable. The big drivers are Navy and refining.

Question (Inaudible)

Jim Lines: The question was, what's driving refining step up? We came off of two or three years of constrained investment by that end market globally and they've gotten back at sustaining investment, keeping their refineries operating and running. So we're seeing a good amount of revamp, replacement of spare parts activity picking back up. And then we've also seen on the global front, new capacity has begun to come into our bid pipeline and we've secured some work for global new capacity, which we didn't see in the 2015, 2016, 2017, 2018 timeframe.

Question (Inaudible)

Jim Lines: The question is, can the business return to its previous mid-teens EBITDA margin level? Yes, it can. Obviously, we need a stronger pull from our refining petchem markets and the Naval market. Now we're hitting full stride with that backlog coming into a stronger level of revenue conversion. So therefore, we do feel strongly that we can return to a mid-teens type of EBITDA level as our refining market compliments the Naval market and petchem begins to pick up. Inherent in that, as the refining market and petchem markets pick up, there's pricing power that comes into our business as demand gets stronger but we haven't seen that just yet. It's getting more favorable than two or three years ago. But it's not yet at a point where we would say, it's representing mid-teens EBITDA margin level. So there are some end market fundamentals that come into play there.

Question (Inaudible)

Jim Lines: The question is, how has the bid pipeline evolved and qualitatively, can we provide any comment about our conference call enthusiasm that we had a couple months ago? We are seeing our bid pipeline become stronger. We have a great business model that we get involved early in projects. So we get to see them in project concept, some of them, nomenclature, concept FEED, which is Front End Engineering Design, then EPC bid, and then ultimately something for purchase. So we've begun to see our pipeline expand with early stage work and then EPC bid that ultimately moves closer to the point in time we'll get an order. And we have a large book of opportunities for the Navy. We have a very nice book of opportunities from the global refining market, and also installed base derived opportunities.

And petchem has been fairly stable over the last couple of years as well. We're seeing the movement to the right, if you will, from concept to FEED, FEED to EPC bid, EPC bid to the contract. Then the RFP is issued for purchase. So we're beginning to see that natural maturation of the opportunities giving us a clearer conviction that we're into an expansionary cycle. Timing has been difficult to predict still. There is hesitancy for final investment decision, but we are watching the work move through the pipeline through the sales stages.

Question (Inaudible)

Jim Lines: The question is, are there other end markets that would value what Graham does? And can we enter those markets organically, or with acquisition? We are looking via our acquisition to, how do we go into what we would call related adjacency, where our value drivers can create value for the customer. And we would be rewarded for that. Navy or Defense is clearly is one of those markets. But there are other markets that we're looking at, how do we play, how do we execute in those markets and create value the way we do in our three markets and extract value for ourselves. So we do recognize those related adjacencies are important to us.

Question (Inaudible)

Jim Lines: We've been on this – we staffed up our acquisition team probably three years ago. We looked at a number of deals. We've moved a number of deals pretty far along. We peeled off a few of the deals because the seller just had too rich of an expectation for our appetite. And most of those were going into related adjacencies or product additions in existing markets, leveraging our sales channel. So some of it was going into new areas and other opportunities were adding product into our existing general management structure.

Question (Inaudible)

Jim Lines: Thank you for your time. Jeff and I will be available if you have any other questions. Thank you, Joe.