LD Micro Analyst: All right. Let's get started. Up next, we have from the Graham Corporation, Mr. Jeff Glajch.

Jeff Glajch: Thank you. Good morning everyone. You'll notice on the second slide a Safe Harbor statement, which obviously I'm not going to read, but we will have some forward-looking statements in this presentation.

Graham is an engineered-to-order product company that serves the energy markets. Our key customers are in the refining sector, the chemical and petrochemical sector, and we provide equipment to the U.S. Navy. We're based in Western New York, and we have a market capital of about $210 million.

So, process-critical equipment that is very complex requires a lot of engineering once we win an order and then very tight fabrication, low tolerance fabrication. Our equipment has a high cost of failure. What that means is, if it doesn't work as designed for our customers, there's a pretty significant cost and risk to them, and our equipment is difficult and impossible to replace. Very importantly, relative to the size of a new refinery or new petrochemical plant, while our equipment might cost multimillions of dollars, it's still a very small component of the total capital costs of that type of a facility.

Key investment highlights of Graham. We're the global brand leader in the markets that we serve. We have an installed base that derives about one-third of our revenue through either replacement equipment or some aftermarket equipment. We are continuing to invest to provide a more predictable base. Some of our end markets, particularly refining and petrochemical are volatile, and cyclical.

We're looking to try to minimize some of that cyclicality by expanding our predictable revenue base, which I'll speak to in a few minutes. We're also looking at acquisition opportunities to do some of that, and we're able to do that because we have a strong balance sheet with strong cash flow generation. We have no bank debt and we have over $70 million worth of cash.

Our strategic focus going forward is to drive our top-line in three different ways. One is to expand the predictable revenue streams, which really is driven by our work with the Navy and taking advantage of our installed base.

Second is to increase our global market share in the refining and petrochemical markets. We have very strong share around the world, but there are opportunities in the certain markets we've not participated in as strongly that what we're looking to going forward.

And then finally, adding new revenue streams, we're using our balance sheet from an M&A perspective. If we're able to do that, we believe we will drive long-term shareholder value and growth, we'll have more consistent financial results and we'll continue to generate cash, which will allow us to, not only invest organically but also, continue to invest inorganically. And at the same time, we have continued to pay dividends to our shareholders.

First strategic lever is the U.S. Navy, and what we believe is the opportunity to improve the margin within that business. The U.S. Navy, as you can see on this chart, really was not a significant piece of our business until about eight or nine years ago and we've seen it grow pretty significantly over the past decade. And we believe that significant opportunity exists in both our current backlog, and just as importantly, what opportunities are out there for us in the future.

When we broke into this business, everything we did was competitively bid. As time has moved forward, we're seeing a little bit more of our business become sole source and we believe as we go forward that more than half of our Navy business will be sole sourced and that provides a level of predictability. Once we've gotten into programs, we're in a very good place with the Navy and its contractors to stay in those programs and to continue to grow our position there.

As the Navy is looking to build more vessels and looking to outsource some of the work that the shipyards are currently doing, we believe there's further opportunity for us to provide products that we've not provided in the past on top of additional growth in the products that we have provided.

So, we're pretty excited about what's in the Navy opportunity. This is part of our predictable business because, while the orders are large, once you have them, they have a three-to-five year order-to-shipment timeframe and are very predictable with respect to the conversion and fabrication work that will occur and, ultimately, the revenue and profit recognition. So, it's much more like an aftermarket business once you have the order than it is like a capital project in the commercial markets.

Our second strategic lever is to take advantage of our installed base. We have an enormous installed base in excess of $1 billion around the world. We've been in business for 80 years. Some of our equipment will last 20, 30 plus years, if it's maintain correctly. Ultimately, that needs some replacement components, but it also can be replaced in kind by us.

You've seen that on both the revenue side and the profit side, the revamps and parts have grown over the past number of years. On top of that, we've become more proactive going after this installed base opportunity. We've hired a sales leader to drive us in that direction. We're putting tools in place to make sure that we've got a good understanding of the assets that are in the ground that we can go after and proactively sell. To be fair, historically, we've been pretty reactive in that way. Over the past year or two and going forward, we're going to be proactive going after these opportunities.

The third area that we're looking to drive revenue is to take a larger market share. We have a very strong market share in North America. We also have strong market positions in places like the Middle East and in China. But we have certain markets that we've not played in particularly. For example, India, we have not played significantly in India. We set up a legal entity very recently, within the last year. We're going after some pretty significant opportunities in India and we're looking to gain share.

How are we going to gain share in places like India? As we have in China, we're going to have to partner with local fabricators. We'll do the detailed engineering work. They'll do some very basic engineering work and ultimately, they'll do the fabrication with our quality surveillance. That's very important. We need our quality surveillance when we subcontract to anyone to make sure that the end product is what we want it to be at the quality level that we want.

Our acquisition strategy, on top of those three organic growth layers, is to build that predictable base, most likely in the Navy or in the aftermarket arenas. What are we looking for? We're looking for someone who's got engineered-to-order products in the energy markets like we have. We want a strong management team with a customer and quality focus like Graham has. Importantly, we want a management team that wants to stay. We don't want to buy a company and change out the management team.

We've talked about a range of $20 million to $60 million in revenue and, depending on the profitability of the business, the range for the purchase price could be in that range also. But it could also be outside of that range – we've looked below and above that revenue range and that cost range. We're pretty open to a lot of opportunities and the key thing is finding the right company that's got the right fit for Graham.

Very importantly, we have strong pricing discipline. A lot of companies will say, hey, I want to make an acquisition, I want it to be accretive. Well, our cash right now is earning about 200 basis points, that's a pretty low threshold. That's not our threshold. Our threshold is to invest the cash much like we invest in a capital project and get a cash return that is in line with an equity type return level. If we're able to do that, we're able to manage the balance sheet as we've proven, the acquisition will be very accretive, but the key threshold for us is not just to be accretive. Let's get a good cash return on the investment as shareholders, we all want that. But to do that, particularly in today's environment, it requires a lot of discipline and we have shown we have that and we will continue to have that.

Following the acquisition strategies I talked about, we're focused on trying to build our predictable base and reduce volatility. The points shown here are in decreasing order of likelihood. The area with our strongest focus is the defense arena. We have a very good position there with the Navy and its key contractors. We believe there's significant opportunity for us to grow and there's fruitful opportunities in the defense market.

The next area we're looking at is the aftermarket. How do we provide additional products and expand our share there? Right now, where we play in the aftermarket is simply replacement components for Graham installations. There's opportunity to expand beyond that.

The third item here is, large capital equipment in the energy or chemical area. Is that a strong target for us? It truly is not. However, if we find that perfect fit, we're certainly willing to consider that. The challenge there is, as I mentioned earlier, the refining and petrochemical markets are quite cyclical. We don't want to add to our cyclicality. We're trying to find a way to grow and to mitigate some of that cyclicality. So, this last one would have to be a perfect fit and a perfect opportunity; we're not ignoring it, but we're not focused heavily there.

Our key end market differentiators, I'll go through these quickly. One is the consultative selling process. We work with the customers when they start to build their facility. They won't put an RFQ out to us for 18 to 24 months after that. But we're working with them that entire time. Our competitors are not. And we believe that providing that engineering capability and knowledge to our customers is important.

We have the ability to manage complex projects. We have projects that require a lot of engineering work. Once we win an order, they frequently stop and start and if our customers change what they're doing, we have to change the engineering. So that happens a lot with our projects and it's something we're able to do.

And then on top of that, we're able to do that, not just on the engineering side, but on the fabrication side as well. There are many times we'll start a project, we'll get partway through fabricating it and, all of a sudden, the customer will say, wait a minute, we've changed this activity. We have to put the project on stop. We re-engineer something, and we start again and move forward. We have a very responsive operating model, with a somewhat unique ability to handle change orders.

And then finally, very importantly, we have tight tolerances that we have to fabricate to. The commercial tolerances are very tight. The tolerances for the U.S. Navy are even tighter. If you think about our equipment, it's going into vessels, in submarines it might last 30 years or nuclear carriers may last 50 years. This equipment physically can't come out. It goes in the bottom of the boat. It's one of the first things, and the only way to get it out would be to cut it out of the bottom of the boat which, obviously, you don't want to do. So, our equipment needs to last for decades and needs to perform.

We have, in the past, had volatile order activity. If you look over the chart here, you'll see over the past two years, a pretty dramatic increase in orders, up about double from where they were at the floor, which ended about 24 months ago. If you look at our fiscal year, our second quarter which ended in September, if you went back to the previous eight quarters and look before that, you'd see a pretty nice step-up. Our commercial backlog has tripled in 24 months. Our Navy backlog has also grown and Navy backlog is great, but it's got a long tenure to it. The commercial backlog, which has an order-to-shipment often of about a year, has tripled in the last two years. That's very encouraging for us, coming off a pretty rough downmarket over the previous few years before that.

If you look at our backlog about half of it is Navy, about half of it is commercial. The Navy part, as I mentioned, converts over three-to-five years. So, about a quarter of that will convert over the next 12 months. Almost all the commercial backlog will convert over the next 12 months. That's why it's important for us to have that strong commercial backlog on top of the Navy backlog. If we don't have a strong commercial backlog, when we end up having to be much more flexible with our work in the plant and it's very challenging to keep the plant moving efficiently. When we have strong commercial backlog, those issues go away.

We can also see our overall backlog has been relatively steady. It's actually at its highest level now if you adjust out a company that we sold this past summer. And year-to-date through two quarters, the book-to-bill has been a little above one. We expect for the full year it to be above one. We expect the backlog to continue to grow and we expect not only growth in this fiscal year that we've seen, we expect growth next fiscal year and beyond.

As we're growing, we're coming out of a pretty rough down cycle in what was our fiscal year 2016, 2017 and 2018, 2018 being the worst of those years. We're starting to see a step-up in the top-line. We saw growth from fiscal 2018 to fiscal 2019 of almost around 20%, and we're expecting further growth in fiscal 2020. Actually, if you adjust out the the company that we divested few months ago, we've actually seen growth of what's remaining of about 20% to 25%. So, we're encouraged there, but we're also encouraged that we're starting to see our EBITDA margins pickup. Our historical EBITDA margins are typically in the mid to upper teens. They've not been there the last couple of years during the down cycle. We will see an improvement going forward and we believe we can get to that mid to upper teens level again in the next couple of years, as we see our productivity improvements expand our throughput, continued improvements in our end markets and finally, our expanded market participation.

We have very strong cash generation. I talked about cash earlier regarding our acquisition strategy. Cash is very important to us. A lot of companies talk about, I've got a lot of net income and you look at their balance sheet and say, what happened? Where'd it go? In our case, that's not the situation. You see about $108 million in net income over the past a little over a decade. About two thirds of that is on our balance sheet right now and the rest of it quite frankly has been distributed to shareholders, primarily as dividend. A little bit of share buybacks, which we do on a rare occasion when we believe our stock price has been grossly affected by something else in the market, but primarily through dividends is how we repay shareholders.

Regarding our capital allocation policies, we are looking to take the cash from operations and reinvest in our business organically and then pay our shareholders dividends. And then we look at our balance sheet and our real focus is our acquisition strategy. That cash from operations is more than what we need, we continue to see cash grow, even during our down cycle we saw our cash grow.

Shareholder focus, we've grown our dividends significantly over the last years and you can see the step-up in institutional ownership. I believe I'm out of time. So, I'm just going to quickly show you our guidance for fiscal 2020, which ends in March, 20% to 26% growth top-line and you can see the rest of the items here.

Thank you very much.

LD Micro Analyst: We have two minutes left for questions.

[Inaudible Question]

Jeff Glajch:

[Inaudible Question]

Jeff Glajch: Sure. The question is on how much free cash flow we generate. Basically, you have to look it it over time; looking at it in a very tight period of time, whether you're looking at a quarter or two is probably not the right way to look at it. We look at it over a year or over multiple years. Our free cash flow generation is in excess of 100% of our net income, depending on where we are in the cycle and what type of growth we're seeing and what kind of earnings we're seeing. We're typically seeing our free cash flow position grow, well in excess of our net income.

[Inaudible Question]

Jeff Glajch: We don't give guidance on net income. We've given the pieces and you can probably get there, but we don't give guidance on net income.

[Inaudible Question]

Jeff Glajch: Sure, sure. The question is what will our acquisitions look like? And then talking through the logic of the divestiture. Let me hit the second question first. The divestiture was a company that we bought in late 2010. We owned for about eight years, eight and a half years, they provided equipment to the domestic nuclear market. When we first bought the company and for about five or so years, it was actually a very good acquisition, generated a lot of cash, generated a lot of earnings. Where it struggled was towards the end of the time as the push away from nuclear power and a little bit more toward natural gas, as well as the increased operating costs of nuclear plants. There, the nuclear market was looking to consolidate suppliers. They were looking for vertically-integrated suppliers, which we were not and we recognized our choice was to either invest in that business or to divest of that business. If we invested, we weren't convinced we were going to get a good return on it given the position that we had. So, we ultimately decided to divest that business this past June.

On the acquisition side, what we're really looking for is a company that's very close to what Graham does. We're not trying to take somebody who is in a market or an activity that's significantly different than Graham. We want someone who makes engineered-to-order products serving either the U.S. Navy or ideally, the aftermarket in our commercial energy markets, who can help, who we believe can take advantage of what we do. We can provide some benefit to them. And hopefully, they can provide some benefit to us. We're not looking for a cost-cutting acquisition. We're looking at how do we drive revenue growth and how do we think about what we do and what they do together, and ultimately grow faster.

LD Micro Analyst: Perfect, thank you so much, Jeff.

Jeff Glajch: Thank you.

LD Micro Analyst: If anyone has any additional questions, please feel free to meet with Jeff outside.