John Beisler: Hello. This is John Beisler with Three Part Advisors. I'm here today to introduce Graham Corporation, ticker is GHM, on the New York Exchange. Presenting on behalf of the company today we have Jim Lines, the President and Chief Executive Officer. Jim, take it away.

James R. Lines: Thank you, John, and welcome everyone. It's my pleasure to be with you at the Midwest IDEAS Conference. Just to remind everyone, I may make forward-looking statements and just please review the cautionary remarks in our Safe Harbor statements.

A quick overview of Graham Corporation; we are an 85-year old company. We provide custom-fabricated, engineered-to-order products and solutions into the defense, energy and process industries. Our general management, or go-to-market, structure is we sell-through a combination of direct sales offices. We have offices in Batavia, New York, Houston and the US Gulf Coast, in India and also in China further supported by a network of 50 independent manufacturer's representative offices globally.

Our primary location of manufacture is Batavia, New York and we also will at times have equipment built via our global fabrication supply chain with partners that we've audited and worked with. We are on a fiscal year that ends March 31, our recent market cap was $140 million, and we have just under $10 million common shares outstanding institutional – Institutional ownership is a strong, at just under 84% and insiders own just over 4% of the stock.

We focus on areas where the applications are critical and cost of failure is extraordinarily high. Our customers have zero fault tolerance, and our equipment's performance must meet specifications precisely. Also, we tend to focus where it's very difficult or impossible to replace our equipment after it's installed. When compared with the overall process we're supporting, our equipment has a low relative cost.

We've chosen to focus here because with those types of attributes, the buyer typically is not focused solely on price. They typically consider a number of other variables and differentiators when they make a decision and that's where we find that we create a lot of value for our customers. In exchange, we extract considerable value for ourselves.

The trailing 12-month sales was roughly one-third from the crude oil refining market, roughly one-third from chemicals and petrochemicals, and just under 20% was sold into the defense industry, principally to the US Navy. We also serve a variety of other markets, power, edible oils and other process industries.

From a geographic distribution perspective, during the trailing 12 months, roughly 60% of our sales has been domestic 15% to the Middle East, 9% to Asia and 15% elsewhere. There's a different breakdown for the last 12 months by orders. Roughly 50% of the orders in the last 12 months were from the refining sector, 25% from the chemical/petrochemical, and 10% percent from defense. The geographic mix of our business can vary and that's mainly due to the size of orders can be rather large and that can create a lumpiness geographically, and also by end-market.

As we look at our end-markets and their fundamentals, as well as our financial performance in the recent past, we have a number of initiatives that we're focused on to improve our margins.

With the tough global economic backdrop we currently have, we know the supply chain has some slack and we're using that to our advantage to have negotiations with our suppliers to drive our input costs lower. That has created some cost savings for orders in backlog, and as we negotiate for new orders that we're striving to book. Also, we are unique, I would say, in that we are looking to add to our workforce even as we're going through this very difficult period of time. We want to add to our production team and also into our professional staff.

We have implemented a Weld School to train our welders here at Graham. We've doubled the capacity from roughly four welders being trained, to eight. We also have an on-site weld lab and a testing facility. And what's important when we're looking to ramp up our personnel to proficiency, improve our onboarding processes and on-the-job training, as well as getting the new worker into production - into revenue generation effectively and quickly.

A key element of our growth strategy and margin improvement is how we're executing on our defense program, our work for the US Navy and what measures and steps we are taking to improve our supplier position, and ultimately and ideally earn sole-source supply status.

The keys to these very complex projects are risk identification and strategies to mitigate risk, ensure on-time delivery for both the technical documentation and the product itself, and a focus on quality- do it right the first time. We want high first pass yield and that applies in the technical areas and also in the product fabrication areas.

Also in our defense program, we are optimizing our fabrication processes. Some of the work we've done in the last several years has been first-article work, a term that really means a first build. As we get through the first-article work, we then optimize our production and workflow strategies, we've seen in the past this drives efficiency and improves the margin for the work that we're executing.

Standardizing operations and procedures for repeat fabrication is critical to margin enhancement and the operating team is focused on that. One of the benefits, if there is one, of COVID has been that as we had workers working remotely, it's caused us to urgently look at how IT could better move business information. We have also looked at how the transactional nature of our work can be more effectively moved across our business.

So we are looking at leveraging IT. We've implemented some measures very quickly as a result of COVID to streamline workflows and to make sure business information is available in real time to our managers and to our personnel through dashboards, so they have the information they need that's credible and influential to the outcomes they're trying to achieve.

As I cited it a little bit earlier, we work with the global fabrication supply chain to create capacity and improve our cost basis and we're building out our organizational structure to support that strategy, and most importantly vendor oversight is a critical component of that quality assurance and quality control, as we put work into the global fabrication supply chain. Building out that organization will not only allow us to drive top line, but also ensure we realize the targeted margins, or improve upon them, after we have an order.

There are four key differentiators for Graham and how our customers think about us and how we believe we create value for our customers. One is our customer-facing consultative selling platform. We're providing very complicated fabrications that go into very complex processes and very complex systems. Before an order is placed, it's critical that we provide knowledge-sharing, engineering support, alongside our customer as they're trying to determine the best way to integrate our product into their process so they can achieve their operating objectives.

We do an immense amount of customer support before an order is placed. We think that's critical for the nature of the work that we do. We feel we do that very, very well and differently from our competition. These orders, of course because of their custom fabrication and the critical performance elements of our products, have a complex order management process. There is design churn, there is interaction with our customer in finalizing the design, there can be starts and stops during the execution, through the office or in fabrication, and this all requires a particular operating model. We are not a high volume, low mix operation. We are more a low volume, high mix one and that's a very different operating model. This requires complex project management and we have a strong aptitude there.

Because of the change order management after we have an order, the design is not yet frozen by our customer in many circumstances. It could be in fabrication where our customer is altering the design, reconfiguring the way it should be put together and we have an operating model that's very adept at that type of execution with the potential forced stops in fabrication.

We do have a way in which we keep enough width on our factory floors, so we can deploy our resources from a project that's been stopped to one that's actively under execution, and that has helped us and we've perfected that over a number of decades. Lastly, these are very large fabrications built to watch-like tolerances with complex weldments, and/or similar materials being welded. We have a strong, strong production workforce that understands how to put these fabrications together to those watch-like tolerances. And that's a unique capability. When we go to those markets that we serve, defense, crude oil refining, chemicals, petrochemicals, they require those differentiators, and they value those differentiators. We have spent a great deal of time over the last several decades perfecting our deliverables across those four differentiators.

One of the growth levers for Graham is our defense, or naval, strategy. The underpinning of that is we want to expand the predictable revenue streams in our business. Defense work is rather predictable, has long-lived backlog. There is a multi-year procurement program with the US Navy that gives us vision and visibility into demand. Over the last decade, we've entered the naval program. The strategy has gone extremely well. We are now on three different programs. We've chosen to focus initially on Naval Nuclear Propulsion and there are three programs there, Carriers, Virginia class submarine, Columbia class submarine, and Graham is now in all three programs.

Now, we're focused on increasing our share of wallet, getting a larger product set in each of those programs. Through our performance and execution along with the differentiators I mentioned a moment ago, we believe we can evolve into a sole source supplier. We can earn that status. That's ideally what we'd like to do, and then also deploy the capital on our balance sheet to derive new revenue streams through M&A in the defense sector or the defense and aerospace sector.

We're expecting our annual revenue in defense to be $20 million to $30 million per year, fiscal year 2021 and onward, up from roughly $5 million per year, five to six years ago. So, that strategy has really evolved quite well for us.

Another strategic lever for us, again with the underpinning of more predictable revenue streams, is leveraging our incredibly expensive and large installed base. Being a company in business for 85 years, we have a very substantial installed base, and as we looked at it and analyzed it in more detail in the recent years, we recognize that there are things that we can do to leverage that differently. If you look from the 2004 to the 2011 timeframe, just under 30% of the revenue came from our installed base, while, during the last eight years, just over 40% has come from our installed base in the form of parts or revamps and retrofits. It also has a higher margin potential, and in those comparative periods of 2004 to 2011, our gross margin from that type of sale was represented about 44% to 45% of our total gross margin coming from our installed base. Today it's closer to 60%.

We're probably in inning number two or three of this strategy. And we think it's immensely important as we go forward not only because it will elevate our level of predictable sales, but also we think our customers in the crude oil refining and the petrochemical markets will invest first in the assets they have before they deploy capital for new capacity investments. And we think we're hitting the strategy just at the perfect time.

As we're going through this particular period of time, we are balancing near-term realities with clear focus and conviction on the long-term. I mentioned increasing our predictable revenue streams. We're executing on a naval backlog year-over-year comparing last year to our forecasted revenue for fiscal 2021. Our naval program work should be up about 50%.

In terms of revenue, again we're focusing on our installed base, however because access to our customers plants has been restricted while the risk of COVID persists, we have had a bit of a pause there. We think that will get rectified in the coming quarters. And we're still focused in allocating greater resources into our installed base and ideally using our balance sheet to bring in more diverse and also predictable revenue streams by acquisition. We're looking for high quality companies that are in the defense or aftermarket space. We're having very good dialogue with the counterparties currently, so we feel very good about that.

Also, another area of long-term growth and opportunity is in our existing markets with crude oil refining and petrochemicals. We didn't fully serve certain segments of that market, which would be the Asian customer base. We're thinking differently about that. We've put strategy in place for how to win in those regions and how to maximize the benefit of the global fabrication supply chain.

We do feel strongly that we can take greater market share in this segment that was underserved previously. And if I think about the order pattern over the last 24 months, about a-third of our orders have been from this sector that we didn't necessarily serve aggressively in our past. So here too, I think we have a very solid strategy that's taking off and will give us stronger volume and has a fine drop-down to operating profit.

We're also investing in our organization, as I said, and we might be unique at this point in time as an industrial serving these markets. We're adding to our personnel. We'd like to have 20 more production personnel. That would be about a 20% increase from where we are. We are also looking to add personnel in our technical areas in sales and engineering and in quality.

As we get beyond these first-article fabrications and we refine our production and workflow methods, we know the backlog will provide a stronger margin profile than what we have had with our first-article execution and we are looking to acquire strong performing businesses, as we have $70 million of cash on our balance sheet at the moment.

I said earlier that we can have a lumpy order pattern. Our orders can be rather large and can vary by end market. The naval orders can be quite sizable as is shown in our defense orders. The economic slowdown really manifested for us in our fourth fiscal quarter and our first fiscal quarter with respect to order pattern which was down quite appreciably.

However, as we are now into our second quarter of fiscal 2021, we have secured, as you saw in our press release, $11 million of orders that have come in in the July and August timeframe. So we are seeing some strengthening of the order pattern and we have a pretty rich pipeline of opportunities that are projected to close over the coming quarters. We think the trough we saw in bookings in quarters in Q4 and in Q1 should be behind us.

Now for a quick overview of the markets: crude oil refining is a market that we're seeing activity in Asia for new capacity, incremental capacity, and revamp-type investments. North America is generally weak, as North America has the integrated oil companies and also the independent oil refiners. Their focus right now is on cash management and as a result, there is a reduction in CapEx and OpEx budgets.

We're seeing a very low order pattern there, and very careful, slow decisions on any investments that are being made for reducing purchase orders. That's a point in time decision that we think they're making. And in our conversations with that segment, we think we have a few more quarters of that ahead of us, perhaps about three to four quarters it begins to turn more positive.

In Latin America and the Middle East, we don't see anything actively in front of us right now, although they're starting to show up in our bid pipeline, which would be opportunities in 2022 and 2023 or 2024.

For the US naval program, there is a pretty active bid pipeline of $40 million to $50 million of active bids. There is activity in all three programs and in some cases they are new components for us - or they would be if we are successful. This is where we can expand our product set of predictable revenue streams.

Chemical and petrochemical really appears to be no different to us than refining. The focus is on cash management during this tough economic backdrop and reduction in consumer demand. We've seen some very erratic decisions around orders, as our customers are really concentrating on cash management. The next wave of new capacity is beginning to slowly come into bid pipeline and we would think this is still a couple of years out before it would be in our order backlog build.

Short cycle sales, that would be our parts and some of our quick turn work, is off about 15% to 20%, although we are seeing some recovery for spare parts and we are also looking at some alternative energy areas around hydrogen fuel for vehicles, compressed natural gas, not alternative fuel, but also supercritical fluids for certain specialty applications as well.

We do have a tremendous backlog. On June 30th, it was at $107 million, of which roughly half is for the defense segment. What's really nice about our backlog is it's long-lived. It has a few years of backlog burn about 70% to 75% of our current backlog is projected to be consumed over the next 12 months. And as I said earlier and as is shown here, we have a nice pipeline of defense-related bids that are expected to close this fiscal year, which would add hopefully somewhere between $30 million to $50 million worth of backlog depending upon our success in securing that work.

As a business – and if you think about this time period 2005 through 2020 for the last 15 years - there have been three very significant energy market downturns, 2008, 2014 and here again today. But across those periods of time, we've been a strong generator of cash and have a considerable amount of net income on to the balance sheet for shareholder distributions in the form of dividends. And we will also opportunistically buy back stock. We have invested in ourselves with just over $30 million of CapEx that we've put into our campus, modernizing some of our machine tools, bringing in modern welding technology, increasing our roofline for the defense strategy, and buying new radiography equipment for x-raying welds. So we have invested in ourselves for process improvement, lead time reduction and improving first pass yield.

I mentioned the strength of our balance sheet a couple of times. We have nearly $70 million in cash. On June 30th, it was $67 million that we are focused on putting to work for new revenue and growth, either organically or through acquisition. Capital expenditures for this current fiscal year are comparable to depreciation at about $2 million to $2.5 million. And typically I think about our business as a 5-ish percent of sales for working capital with what's happened with the last three or four months, leading up to June 30th.

We did have an increase in our working capital as a percent of sales. I feel that should get back to where it was as we move out of and recover from this current COVID-related slowdown by our customers.

With the balance sheet and our operating cash flow that has been strong, our capital allocation priorities are to put operating cash flow back into the business and to also pay a consistent dividend that increases over time. For the cash we have on the balance sheet that would be for acquisitions, we're not looking for acquisitions that are simply accretive to EPS. We have an internal hurdle rate for an IRR metric that's consistent with an equity-based return hurdle. And also, we would look to use our balance sheet where appropriate to buy back stock.

Regarding our acquisition strategy, we're looking for businesses that have revenue in the $20 million to $60 million range. The transaction value would be 1 times revenue to maybe 1.5 times revenue depending upon which market we're in. Importantly, we're looking for businesses that have a strong and capable management team with similar focus on growth, focus on the business, focus on the customer that Graham has. And importantly, they want to stay after the acquisition.

We want the business to provide a level of predictability, or revenue that we can view as predictable over time. I mentioned we want a cash return that exceeds our hurdle rate, which is comparable to an equity-based return. And they value of the product they're providing and the pricing strategies to ensure they're properly paid for the complex and very critical components that they are providing.

Concerning the end markets we're looking for an acquisition in, our primary priority is in defense because we think that has the best end market fundamentals and where we like the long-lived backlog and the predictability that this segment brings us. Here we'd like to expand our participation with additional products in the programs that we're currently in and then also add new programs, and new revenue streams. In the aftermarket area, again that's a more stable revenue stream. What other products and services can we provide to take more share of the wallet in that regard?

Energy and chemical, it would be our third a

We have a clear focus on our shareholder. We've had increasing dividends over the last number of years. Last year fiscal 2020, we paid $4.3 million in dividends. And as you can see our board has had a program to increase our dividends over a period of time.

We do have a strong IR program where we meet and communicate with the investment community which has grown our institutional ownership from when this management team took over at about 35% of our shares held by institutions to today when 84% is held by institutions. We have sell side coverage from three firms Sidoti, Maxim and Litchfield Hills.

Investment highlights, so we're not looking at this particular downturn as a "let's hunker down and just try to get through it' period of time, but rather we're looking at it as how do we take advantage with the strengths that we have on our balance sheet, the strength of our brand, the strength of our people to make the right investments during this downturn so we come out stronger.

We have a leading market position in the markets that we serve. We have an incredibly powerful global brand, in particular in the refining and the global petrochemical markets. We have a massive installed base that's over $1 billion of value and our installed base in some manner is somewhere between 30% and 40% of our revenues per annum. We have a strong acquisition program with a keen desire to put the balance sheet to work through business combinations to create new revenue streams for us and we have a very solid operating model where we can derive a great deal of operating leverage as volume increases.

With that, we do appreciate your time. Thank you.