Brett Kearney, Analyst, Gabelli Funds: All right. Closing out our program today, we have Graham Corporation. Graham designs, manufactures and sells critical equipment for the energy, defense, chemical and petrochemical markets. The company's products include custom-engineered vacuum pumps, surface condensers and ejectors. Graham has 10 million shares outstanding. The stock trades around $16, with $160 million market cap, $69 million of net cash, and $91 million total enterprise value.

Joining us today from Graham is CEO, Mr. Jim Lines. Jim has been CEO of Graham since January 2008, and previously served as COO and a Director of the company since 2006. He first joined Graham in 1984, and has held leadership positions in engineering, sales and marketing, and product management. Also joining us is CFO, Mr. Jeff Glajch. Jeff has been CFO of Graham since March 2009, after previously serving as CFO of Nukote International, as well as CFO of Fisher Scientific Canada. Jeff also previously held financial leadership positions at The Walt Disney Company, Great Lakes Chemical, and Air Products and Chemicals, Inc.

So, Jeff and Jim, thank you very much for joining us today, and Deborah as well. Thank you.

Deborah Pawlowski, Investor Relations: Thank you.

Jim Lines: Thank you, Brett, and good afternoon, everyone. We're happy to be here. We have a few initial slides we'd like to walk through before we open it up to Q&A. I would like to just remind everyone that we may make forward-looking statements, and just apprise yourself of the cautionary remarks here. Very quickly, for Graham, this is our 85th year. Next month is our 85th birthday. We are a manufacturer of critical equipment to the defense, energy and process industries. We provide custom-engineered, custom-fabricated products and solutions.

How do we go to market? We use a combination of direct sales personnel, and we also work with over 50 independent manufacturers, representatives throughout the world in the U.S., Middle East, South America and Asia. We have our company offices in Houston, on the U.S. Gulf Coast. We've opened up a subsidiary structure in India, and we also have had a subsidiary structure for sales and marketing in China since 2007. We do have an $0.11 per quarter dividend.

Okay, Deb, we'll move on to the next slide.

Where we market our capabilities and where our differentiating characteristics are valued is for very critical applications, where performance, reliability, quality and absolutely flawless performance is necessary and where the cost of failure is extraordinarily high to the user. That's where we find that we fit best. Those are types of applications where the relative cost of our product to the overall facility or the overall naval vessel is relatively low. Once installed, it's not impossible, but very difficult to replace or remove our type of equipment; so therefore, it must perform according to specifications to enable our customers to meet their performance objectives or the defense segment to meet its mission objectives.

Our key markets are, as I said, defense and, in the energy space, it's crude oil refining. We also serve the petrochemical markets and related other adjacencies. During the trailing 12 months, we've had a book-to-bill of about 1.25 to 1, $95 million in sales, and just over $120 million in new orders. You can see in the lower left that our sales pattern is 55% domestic, 45% international, with all of our Navy or defense sales being domestic. If we extract that, our commercial sales are on the order of 40% U.S., 30% Asia, 10% Middle East and 20% to the rest of the world.

We're focused on expanding our base of predictable revenue streams. The defense strategy, the naval strategy fits perfectly with that objective, and our goals are to increase our market share, increase our share of wallet. I said earlier that we're coming up on our 85th year. We have, as a result, a very significant, rather large installed base in North America and it's our belief, and we're allocating resources accordingly, that our customers will invest first in the assets that they have before they move on to a greenfield investment.

This is an interesting depiction of the evolution of that investment in the installed base. For the five-year period between 2005 and 2010, it largely was a new capacity market for us. About three-fourths of our revenue was in the new equipment area and just under 30% was from our installed base. Today, the last five years, revenues derived from our installed base are about 50% of our revenue from our commercial sales and 50% for new equipment. As you might imagine, revenue derived from our installed base has a higher margin profile.

When I say from installed base, there are really two or three types of revenue drivers we have there. It's classic replacement parts as our equipment wears, and they are in corrosive and erosive environments, so there is a replacement revenue stream. And then, also, as our refining or petrochemical customers look to maximize what they can get out of their existing facilities, there's a revamp and there's a retrofit revenue driver that's of equal importance to parts. In total, those both equate to about half of our revenue today and a pretty large percentage. The majority of our gross profit is derived from those two revenue streams.

We are fortunate that we have had, and it's still expanding, a terrific high-quality backlog. Our backlog as of the end of December was just under $150 million, of which 70% is for defense, 20% for crude oil refining; quantitatively, $105 million for defense and $45 million from our traditional commercial markets. What's important in the graphic in the lower left is how much of that backlog converts over the next 12 months. We are modeling conversion of 45% to 50% of the $150 million will convert over the next 12 months. The naval work, the defense work, is long-lived backlog. Order to shipment could be one year to five years depending upon the contract; so therefore, it gives us, as a management team, a nice level of predictable base and a great deal about your predictability of the direction of our business. Next slide, please.

Since late 2014, the energy markets, for all intents and purposes, have been in a downturn. During that period of time, we've managed to cross that with our defense strategy, with our installed base strategy, and we've generated strong cash flow during a constrained environment in our energy markets. We've had a similar level of net income on an adjusted basis as cash flow from operations.

And then, we did return to our shareholders $18.8 million in the form of dividends, and we did have a few small repurchases. We invested in ourself. We put $8 million of capital into our facilities to enable us to work more productively and to support the defense strategy. So, while operating in a very rough environment, we were able to convert net income, basically dollar for dollar on an adjusted basis, to free cash flow; and then, we've actually increased our cash position across the 3.5 years, 4 years.

Our balance sheet is in very good shape for what we've had to go through most recently. We're very fortunate to have had such a strong balance sheet. We have just under $7 a share in cash, or just under $70 million as of 12/31. Operating cash flow is as we described and as I discussed previously. Our capital investment level, provided we're not doing something strategic to enable us to take on new revenue streams, is typically around $2.5 million, or around 2% of sales, in nominal terms, and our working capital utilization varies between 0% and 10% of sales. As of December 31, it's just under 10%. That's tied to timing of receivables and that should be driven down in the subsequent quarters as we look forward. Next slide.

So, as you think about Graham as an investment, we do have a very strong position in the end markets and for the applications that we participate in. We have a very strong global brand. We are deriving a large percentage of our revenue from our installed base, somewhere between 30% to

50%, depending upon the strength of new capacity investments by our markets. The strategies that management has implemented to increase the level of our predictable base business has been coming home and the naval strategy exemplifies that.

With our balance sheet, we are looking for acquisitions. We are spending a lot of time in the defense space, looking at targets there and nurturing those opportunities, as well as in other more stable revenue segments. Our balance sheet, as we talked about a moment ago, is in really good shape and we intend to put that cash to work. As our business performs and as volume expands, we have a powerful cash generation engine, and we do create a lot of operating leverage on incremental volume.

With that, I think it would be best to open the call up to field some questions.

Brett Kearney: Perfect. Thanks, Jim. That was a great overview. I'll kick off; and then, we'll take questions as they come in from the audience.

So, you went over the great position you built with the U.S. Navy. I was wondering if you could talk about potential incremental organic growth opportunities on that business for Graham going forward.

Jim Lines: Sure. We entered the program with a rather narrow focus. We participate around the nuclear power island, and the components and equipment that go around that. We had a pretty narrow focus, so we made sure we had the right entry point and we could execute very well on the orders that we won. There are other fabrications, other weldments and other components around the power island, or closely associated with it, that we also could provide, and our team is looking at how do we participate in expanding our offer to the U.S. Navy.

Brett Kearney: Perfect. And I think you've recently spoken about opportunities for Graham in the ongoing energy transition. Could you discuss at all the market potential for Graham products in say the renewable diesel/biodiesel markets?

Jim Lines: Sure. Now that is an actual active area in refining today. We are seeing a considerable amount of interest in actual investment in renewable diesel, a new capacity or reconfiguration of refining assets. There's tax policy that is supporting that. Those projects have a lower ASP selling price than our typical refining projects, but there are two areas that we participate in. One is on the renewable feedstock pre-treatment to condition the feedstock to be provided to the refinery that requires our vacuum equipment. That's technology that comes from the edible oil industry, so we know those technology providers; we know that market very well and we participate there. The ASP there is somewhere around $100,000 to $250,000 per opportunity. And then, once inside the classic refining process, there are our applications as well around the hydrotreater, hydrocracker, that require our vacuum technology, also similar ASP. It's not like a seven-digit project that we see from the refining market for our usual projects, but this is very nice work and we're focused on participating in it.

Brett Kearney: Great. Are there other areas of newer fuel types out there, carbon reduction applications, compressed gas and other areas, where you expect your technologies to play a role?

Jim Lines: Sure. We have this really phenomenal heat transfer technology that really was at our origins back in 1936. It's a small compact heat exchanger that's ideal for high pressure applications. The compressed natural gas and the hydrogen economy are processes that operate at relatively high or very high pressures. With compressed natural gas, we're seeing those in the 3,000 PSIG to 5,000 PSIG operating pressure ranges, and for the hydrogen economy, for the compression and then dispensing, the hydrogen is around 10,000 PSIG. That's a very specialized technology area that we have, and we've been providing our equipment into compressed natural gas, more for trucked natural gas distribution, where we provide our high pressure heat exchanger for natural gas heating.

And then, on the hydrogen side, we work with the compressor technology companies that are taking the hydrogen and boosting it up to 10,000 PSI. Our heat exchangers work in those applications. And then, we've done a little bit of work on the fuel dispensing side, the hydrogen dispensing side, where the hydrogen is at 10,000 PSI and there's a heat exchanger to pre-cool the hydrogen before it's delivered to the vehicle. The ASPs…these are $10,000 to $40,000 types of sales, very nice bread and butter work. We're working with a number of technology companies that are developing prototypes. So, we're where we want to be. We're in early, we're participating and I think we have a really nice technology that fits there remarkably well.

Brett Kearney: Perfect. Looking at traditional refining in petrochemical markets, you have had some nice wins in India recently. Can you talk about the strategy that the company's employed in that market that have led to the successes there?

Jim Lines: Sure. For such a long time we had, what we called or would refer to as, an outside in strategy. We would export from here in the U.S. and provide our products into India, and some multinational partner would carry us in, an EPC or a multinational or a global OEM. As we looked at the way India would be investing in its infrastructure and the policies from the government around "Made in India," we changed and localized our strategy where we would produce equipment locally with fabrication partners. And then, we also set up a subsidiary structure where we could nurture opportunities, sales and marketing, and be closer to the customer, so our technocrats could be where the decision-makers are. We entered that strategy in this manner about two years ago.

We've won two very significant projects from two customers we never worked with before in this capacity, and these are sizable projects. They are multimillion dollar projects, $4 million or $5 million, really nice work for us. So, we had to change our execution to change our participation in our success. Thus far, after two years, we're moving the market toward us rather than us having to move toward our competition. I'm very happy with that and it's playing out analogous. It's still early, but our hope is we can have that strategy evolve and benefit us the way in which our China strategy did over the last 10 years to 15 years, where we pulled the market toward us rather than us having to move toward the local competition.

Brett Kearney: Great. We've heard from some companies about challenges they've been facing with their skilled labor as demand is starting to come back in certain markets. Can you talk about some of the unique programs you will have in place and the investments you have made to continue to onboard or retain skilled labor at Graham?

Jim Lines: That's a great question. Candidly, there's definitely a supply issue. We have been adding to our skilled labor workforce. One of the things we did in response to a scarcity of welders is, we've invested to create a welding school in our campus where we can develop our own welders. We're able to train 10 individuals concurrently in our weld school, where we teach them how to weld or, if they're already capable of doing some welding, teach them how Graham welds with these special metallurgies in these unique geometries that are required.

That has been a great decision, because we couldn't be captive or hostage to a supply problem. We had to resolve that. We also shifted our brand a little bit. Our HR team did a remarkable job of promoting Graham as an employer, which created interest in us. So, several things that we've done have helped us, but I would say there still is a supply issue. We have a need for 20 more welders and machinists and, if we could hire them today, we would. We could put them to work right away; we have that much demand.

So, it's important for us to resolve. Our team's been working on it and one of the things we did, again, was set up a weld school where we would develop our workforce here.

Brett Kearney: Okay. And then, could you provide some detail on a few of the margin expansion initiatives the company has underway across vendor management as well as the IT systems you're implementing to enhance productivity?

Jim Lines: One of the things that we had observed in other downturns and we felt it would manifest here again is, as there's slack in the supply chain, we aggressively leveraged that to our advantage in our negotiations with suppliers or in finding suppliers that have capacity to drive down our procurement costs. That sits on the shoulders of our supply chain management personnel to drive and to hammer our suppliers the same way our customers are hammering us for absolutely the best price. I've been very pleased with the way in which our supply chain has been able to procure and improve our margins with procurement strategy.

On the business information side, what an employee needs is the intelligence and the business information to do their job while they're doing it, so we've been putting together some dashboards and some IT tools, that makes the worker able to have the information they need to do their job effectively and efficiently. We're also trying to push, so the information is where the decision needs to be made, right where the worker is rather than have the information go to a leader and then they make the decision.

So, we're trying to provide the business information flow, where the worker has what they need when they need it, so they can make the right decision and execute their work efficiently, productively and to the right quality.

Brett Kearney: Great. Have you considered starting a corporate sponsored SPAC to leverage your acquisition strategy?

Jim Lines: Jeff, do you want to field that one?

Jeff Glajch: Sure. I'm sorry, Brett. I missed the first couple of words of your question.

Brett Kearney: Have you considered starting a corporate sponsored Special Purpose Acquisition Company to leverage the acquisition strategy?

Jeff Glajch: Thank you. We have not at this point, but we're really more focused on the targets of where we are now. We have not looked at a SPAC yet.

Brett Kearney: Okay. And following on that, Jeff, what kind of internal as well as external resources are supporting Graham's acquisition efforts?

Jeff Glajch: That's a great question, Brett. For our internal resources, we have a Director of Business Development that we hired about three or four years or so ago; myself, I'm spending a good portion of my time on the acquisition side; Jim, of course, is spending a good portion of his time; and then, we'll pull in certain individuals depending on the expertise that we need from an internal standpoint. We also have great support from our Board of Directors, who have some resources there that provide a very strong guidance to us as we look at acquisition opportunities.

Externally, we haven't worked too much with the investment bankers, only because our process is not one of looking for somebody that's necessarily for sale right now, but rather building relationships with companies that may not be for sale, but at some point in the future might be interested in a sale process. That doesn't necessarily align itself really well with a banker who may be looking at actual companies that are for sale right now.

That being said, we do have a couple of bankers that we have worked with, and certainly, if someone brings something to us, we will consider it and look forward, but most of our work is direct to companies through, primarily, our Director of Business Development, Chris Johnston.

Brett Kearney: Okay, great. And then, with the size and quality of the businesses you're targeting, is it fair for us to expect that you'll end up deploying maybe half to all of Graham's cash to a potential acquisition?

Jeff Glajch: You know, Brett, we've been pretty open that our target range is $20 million to $60 million of revenue. If you assume there are well run businesses that have pretty strong operating margins, then the price is likely to be more than dollar-per-dollar of revenue. That being said, that would get us to probably half to perhaps all of our cash available, if we stuck in the $20 million to $60 million range. We've also looked outside of that range, both below as well as above it. I do think it is fair to say that, if we find the right acquisition, we would ideally like to use a large portion of our cash position if we can find that right opportunity. And so, if we're successful, I think that's a fair expectation.

Brett Kearney: Okay, great. And then, I have one last question. We've heard from a number of companies today, obviously, the raw material pressures thus far this year. Can you talk about how Graham is managing those, especially when executing your backlog and some longer dated project work?

Jim Lines: One of the things we've done successfully and certainly, more importantly, in rising material market environments is the way we structure our contracts with our customers. We are enabled to procure critical equipment or material as quickly as possible after the order, so we avoid that risk and we move very quickly to procure the volatile materials once we have their specs and their designs established. That, typically, can happen two, four or six weeks after we have the order, so that's the time-based risk that is typically on the order of that duration.

The same is true for the long lived naval work. We would move quickly to procure materials that are subject to time-based risk and have cash flow from our customers enable us to finance that or they finance that for us. That's been our strategy. We don't like to lose margin, because we played the metals market. We'd rather miss a little bit of savings when the market is less advantageous for us and just take risk out of our COGS and that's what our purchasing team has done. That's how we operate.

Brett Kearney: Perfect. Alright, this has been really great color. Jim, Jeff and Deborah, thank you so much for joining us. We really enjoyed having you today.

Jim Lines: Thank you for having us. It's always great to be here.

Deborah Pawlowski: Thanks, Brett.

Jeff Glajch: Thank you.