Graham Corporation
Third Quarter 2009 Earnings Conference Call
January 30, 2009

Operator: Greetings, and welcome to the Graham Corporation Third Quarter Fiscal 2009 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero, on your telephone keypad. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Ms. Deborah Pawlowski, investor relations for Graham Corporation. Thank you, Ms. Pawlowski. You may begin.

Deborah Pawlowski: Thank you, and good morning, everyone. We appreciate your joining us today on Graham Corporation's third quarter fiscal 2009 financial results call. On the call, I have with me today Jim Lines, President and CEO of Graham Corporation, and Jennifer Condame, Chief Accounting Officer. They will be reviewing the results of the third quarter and progress on the company's strategies. You should have a copy of the earnings release that was put out this morning. If not, you can access it at the company website, which is www.graham-mfg.com.

As you are aware, we may make some forward-looking statements during the formal 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 that could cause actual results to differ from what we've stated here today. These risks and uncertainties and other factors are provided in the earnings release, as well as other documents filed by the company with the Securities and Exchange Commission. These documents can be found at the company's website or also at www.sec.gov.

So with that, let me turn it over to Jim to begin the discussion.

Jim Lines: Thank you, Debbie. As you can see from the release, we had a very strong quarter and based on our outlook expect to end the year on a record note. As I have discussed over the last couple years, we have seen a steady surge of orders coming from the refinery and petrochemical sectors. We recognized early last year the petrochemical industry was beginning to tail off, and the question had always been when would the oil refining market cool. That question was basically answered during the December-ended quarter.

Because I am sure the future is foremost on your minds, I will give you what little insight I have and offer my thoughts on that. And Jennifer will cover the results for the quarter and our expectations for the year; that is not to say that you should discount the results of the last nine months, but what we believe fiscal 2009 will represent.

We're a company that has, in effect, doubled in size in the last three years without expanding its roofline, by using flexible costs to support that growth such as the use of subcontracting, adding contract employees, flexing the use of overtime, and adding some full-time staff. The company has become more efficient with cash management initiatives and has continued to improve our level of service provided to customers. Also, and very important entering a downturn, is that we have maintained a pristine balance sheet with virtually no debt. Our pension assets are in good shape, and we have ample cash for continuing to invest in our company. This is a different company going into a downturn. We are stronger financially, more flexible from a cost structure perspective, and in a better position to more readily expand after the bottom than we were in 2004.

It is difficult to forecast at this moment in the short term, due to what was occurring in the financial markets and the global economy. Long term, we continue to see energy demand growing and creating increasing need for our products and services. I can draw comparisons that will frame possible short-term performance. There have been three significant energy market abrupt adjustments during the past four decades. One in the mid '70s, another early '80s, and the last was late 1990s that was led by the Asian currency collapse. In each case in the past, revenue from peak to bottom dropped 30 to 35%. The current environment feels to me to be similar to the late '90s when credit tightened in Asia, projects in the pipeline dried up, petrochemical and refining activity pulled way back. There were mergers and acquisitions that put on hold energy market investment and new capacity.

During the late '90s and early 2000s, our operating margins were negative. Cost structure was too high for that environment. By comparison, if our top line were to drop by 35% comparing fiscal '09 to fiscal '10, we expect to remain profitable. Under that scenario, which is a 35% year-over-year reduction to top line, we anticipate gross margin in the 28% to 31% range and SG&A expenses between $13 and $14 million. It is too early to cast light on 2010 with so much uncertainty around the credit markets, price of crude oil, and energy market investment. However, I did want to provide a sense for how operating performance would compare if the market downturn this time is comparable to prior pullbacks.

Again, I believe Graham is truly different today in how it can expand during up cycles while controlling fixed costs and weather a downturn as it concentrates on furthering internal improvements, investing to strengthen the company, and continuing to expand its markets and market share.

It was noted in the press release that we did make reductions to staffing in January. Our cost control measures, including the announced reductions, are planned to lower cost approximately $2 million for fiscal 2010. We have reduced the level of subcontracting that's being done and are keeping as much work in house as possible.

Let me go into some detail regarding what we are seeing in the oil refining industry. We have had one significant cancellation of an order in backlog. It was for a US refiner investing in feedstock diversification. The value was about $1.6 million. The order was won late in our second quarter and was cancelled early in the third quarter. We did receive an engineering fee for the work completed.

There are five or six orders in backlog that have been put on hold by our customers. All but one is from the refining sector. That one is for the ethanol market. We are monitoring backlog carefully to understand credit risk, know our cash position on each major contract, and to stay close to customers to understand project schedules.

Our sales and application sharing personnel remain busy. There is a lot of opportunity in the pipeline. What remains difficult to ascertain is when purchase commitments will be made by customers. We are sensing the end users are taking a wait-and-see attitude. They know the supply chain is softening. We have heard end users expect the cost of building their new plants to come down 10% to 15% by waiting six to 12 months. They seem prepared to wait a little longer.

Petrochemical seems to be following its normal pattern for capacity additions during the past three to four years leading to a slowdown that we began to notice about one year ago. There are still good orders in the pipeline to be won for petrochemical work. It is expected to be at a lower level than the past couple years. And again, the timing for order placement remains unclear.

Other markets, including power generation, alternate energy, and nuclear energy, rely more so on credit markets than does refining. These markets require reassessing the short term, and I plan to update you on this during a future conference call.

I will now turn it over to Jennifer.

Jennifer Condame: Thank you, Jim. For the third quarter of fiscal 2009, which ended December 31, 2008, we reported net sales of $24.7 million compared with $20.6 million in the third quarter of fiscal 2008. Sales of ejectors, heat exchangers, and pump packages grew considerably, while sales of condensers and aftermarket products were down approximately $1 million on a combined basis.

As we near the peak of the projects we've received for refineries over the last year, ejector sales increased 47.7% to $10.3 million, or 41.6% of total net sales in the third quarter, compared with $7 million, or 33.8% of total net sales, in the third quarter of fiscal 2008. Heat exchanger sales increased 23.9% to $3 million, or 12.1% of total net sales in the third quarter, compared with $2.4 million, or 11.7% of total net sales, in the same period the prior fiscal year. Pump package sales were $1.8 million, or 7.5% of total net sales in the third quarter, compared with approximately $600,000, or 2.9% of total net sales in the third quarter of fiscal 2008. Condenser sales declined 4% in the third quarter to $6.8 million, or 27.5% of total net sales, compared with $7.1 million, or 34.3% of total net sales in the fiscal 2008 third quarter as the petrochemical industry slowed during the latter part of 2008. Aftermarket product sales were impacted by the timing of customer requirements for repair parts and decreased 21.8% to $2.8 million, or 11.3% of total net sales in the third quarter of fiscal 2009, compared with $3.6 million, or 17.3% of total net sales in the prior fiscal year's third quarter.

As a reminder, due to the large magnitude of certain orders and the timing of shipments specifically related to ejectors and condensers, quarter-to-quarter sales fluctuations are common and don't necessarily indicate a trend.

By industry, 46% of sales in the third quarter of fiscal 2009 were to the refining industry compared with 38% in the same period the prior fiscal year. Approximately 27% of sales were to the chemical and petrochemical industry, and 21% to other industrial applications during the current quarter. This compared with 42% and 19%, respectively, in the third quarter of fiscal 2008.

Power industry sales accounted for 6% of sales during the third quarter of fiscal 2009, while in the fiscal 2008 third quarter, this industry represented approximately 1% of our total net sales.

On a dollar basis, international sales in the third quarter increased slightly to $10.3 million but declined as a percent of sales to 42% compared with 48% of sales in the third quarter of fiscal 2008.

Turning briefly to a review of year-to-date sales results, total net sales increased 19.8% to $76.3 million during the first nine months of fiscal 2009 compared with $63.7 million in the same period of fiscal 2008. All product groups advanced except for ejectors, which had a decline in sales of $2.4 million. Aftermarket product sales increased $5.6 million, pump sales advanced $4.7 million, condenser sales were up $2.7 million, and sales of heat exchangers improved $2 million.

We received $8.1 million of orders in the third quarter of fiscal 2009, down from $26.6 million in the same period the prior fiscal year. The order decline was seen across all product groups. By region, a decrease in orders from U.S. customers led declines from most geographic locations, with a notable exception of orders from the Middle East, which saw a strong increase. U.S. orders for the third quarter represented 62% of total orders, compared with 74% in the fiscal 2008 third quarter. Orders in the third quarter from the refining, chemical and petrochemical and power industries were also down. For the nine-month period, total orders were $53.4 million compared with $72 million in the fiscal 2008 nine-month period.

International orders represented 55% of total orders, and U.S. orders were 45% of the total orders. This compares with 28% and 72%, respectively, in the same period of fiscal 2008. Orders from customers in Asia drove this increase, as they advanced to $19.1 million, a 335% increase from the nine-month period in fiscal 2008 and represented 36% of fiscal 2009 year-to-date orders. Canadian, Middle Eastern, and African orders were also up, while U.S. orders were down 54%.

By product, orders declined in all product groups except heat exchangers, which were up slightly.

By industry, 37% of orders during the nine-month period of fiscal 2009 were from the refining industry, 27% from the chemical and petrochemical industries, 1% from the power industry, and 35% from other industrial applications, compared with 53% the refining industry, 21% to the chemical and petrochemical industries, 7% to the power industry, and 19% to other industrial applications in the prior year nine-month period.

At the end of the third quarter, backlog was $52.5 million, down 16.7% compared with $63 million at the end of the third quarter of fiscal 2008. The quarter end backlog number excluded the $1.6 million canceled order, while included in backlog is approximately $5.7 million in orders to refinery projects that customers have currently suspended subject to further review of the related projects.

Approximately 45% of projects in backlog are for refinery projects, 33% for chemical and petrochemical projects, and 22% for power and other industrial or commercial applications compared with 50%, 23%, and 27%, respectively, at the end of the fiscal 2008 third quarter. Excluding $5 million of suspended orders, we expect approximately all of our backlog will ship in the 12 months.

I will now review Graham's operating performance for the quarter and nine-month period.

Gross profit in the third quarter was $9.4 million, or 37.9% of sales, compared with $8.6 million, or 41.9% of sales in the fiscal 2008 third quarter. A large project requiring international fabrication was in progress in the current quarter and carried a lower gross margin than projects in process during last year's third quarter.

For the nine-month period, gross margin was 42.1% compared with 39.6% in the fiscal 2008 period. Higher aftermarket sales, improved product mix, and engineering and manufacturing operating efficiencies all contributed to the year-over-year increase. We continue to expect fiscal 2009 gross margin will be consistent with our previous guidance of approximately 39% to 42%

SG&A expenses as a percent of sales declined to 14.4% in the third quarter of fiscal 2009 compared with 15.7% in the fiscal 2008 third quarter and 16.4% in the trailing second quarter of fiscal 2009. Expenses were $3.6 million in the current quarter, $3.2 million in last year's third quarter, and $3.9 million in the trailing second quarter of fiscal 2009. Costs related to our ongoing initiatives to improve manufacturing efficiencies and increase bonus and commission accruals, as a result of higher sales and net income, caused a slight increase in SG&A expenses in the current fiscal year quarter compared with the same quarter in the prior year.

In our fiscal fourth quarter of 2009, we expect to recognize a charge of $365,000 related to the restructuring that Jim discussed earlier. Including the restructuring charge, we expect that SG&A expenses to be in the range of 15% to 16% of sales for our full fiscal 2009 year.

Interest income in the third quarter of fiscal 2009 declined to $83,000 compared with $304,000 in the same period the prior fiscal year, primarily as a result of a significant decline in current treasury yields compared with a year-ago.

As we discussed on our last call, in light of the uncivil markets that developed in 2008, we now invest strictly in the US Treasury Securities, which had maturities of 91 to 180 days at December 31, 2008. Previously, our portfolio included US sponsored agency notes, which carry somewhat higher yield.

We revised our estimated fiscal 2009 effective tax rate upward by 0.5 percentage point to 34% in light of the actual rates experienced and our recently filed tax returns. This revision resulted in an effective tax rate for the third quarter of fiscal 2009 of 35.5%.

Net income in the third quarter of fiscal 2009 was $3.8 million, and earnings per diluted share were $0.37, unchanged from the fiscal 2008 third quarter. Net income for the first nine months of fiscal 2009 was up 28.1% to $13.9 million compared with 10.8 million in the same period the prior year. On a diluted per share basis, net income grew to a $1.36, a 25.9% increase over a $1.08 in the same period the prior fiscal year.

Cash, cash equivalents, and investments were $45.4 million at the end of the third quarter of fiscal 2009, up from $36.8 million at March 31, 2008, and $42.9 million at the end of the trailing second fiscal quarter. There were no borrowings on our $30 million revolving line of credit at the end of the third quarter and $7.5 million outstanding in letters of credit.

Net cash provided by operating activities was $7.4 million in the first nine months of fiscal 2009, down from $16 million in the same period the prior fiscal year due to higher working capital primarily from an increase in accounts receivable balance due to the timing of customer billings.

Capital expenditures were $398,000 in the third quarter of fiscal 2009 and $1.2 million for the nine-month period compared with $212,000 and $659,000 in the third quarter and nine-month period of fiscal 2008, respectively. Capital expenditures for the full year fiscal 2009 are expected to be in the range of $1.8 million to $2 million. An estimated 75% of our fiscal 2009 capital spending is expected to be used for productivity improvement and the remaining 25% for capitalized maintenance and other general purposes.

That concludes my remarks. Jim, I will turn it back to you.

Jim Lines: Thank you, Jennifer. As you may have noted in our press release, Graham's Board of Directors authorized a stock repurchase program permitting the company to repurchase up to one million shares of its common stock. The repurchase program will continue until July 29, 2009, or until such time as we've repurchased one million shares. Graham intends to use cash on hand to fund the stock repurchase program. Given the uncertainty and fluctuations in the marketplace, this is a vote of confidence by our Board of Directors in the long-term outlook for the company.

At this time, we will take your questions now.

Operator: We have our first question from Mr. Rick Hoss with Roth Capital Partners.

Rick Hoss: Good morning. Looking forward, are there further reductions available based on expected decline in top line? Are there other things you can do at this point?

Jim Lines: There are other things that the company can do to control its expenses or lower its expenses and that will depend upon how we view the short-term and long-term outlook.

Rick Hoss: Okay. Secondly, regarding the delay of projects, it seems like the rationale behind a few of them, at least the Saudi projects I've read about, is really the oil company wanting to delay just to get the better pricing. And I know you talked about that previously on what the expectations of waiting the 12 to 16 months so you get 10% to 15% off. To me, that implies that the demand is still there and that while you've seen a rapidly deteriorating order volume or order interest in say, the last three months, thinking about long-term demand trends, the demand is still there, and this is really just a pause as everybody sort of waits it out and figures out what's going on here and, you know, how do we prepare for it. Any thoughts on that Jim?

Jim Lines: I believe you assessed it right, Rick. As you might be aware, the metals markets has come down significantly, copper, nickel, carbon steel. Those are off from their highs of six to nine months ago, almost two- and three-fold. So that needs to work its way into the end-user project cost, which is hasn't yet fully. And they expect as the supply chain softens that they can realize cost savings of that order of magnitude. While the underlying reason for the investments really hasn't changed, the long-term demand growth projections have not changed. And they're prepared to wait to let their costs come down and be more sensible and in alignment with the market price for oil that also has come down appreciably.

Rick Hoss: Okay. So the scenario could be, you know, at 2010, you have a drastic drop, but the drop happens so quickly that maybe that is the bottom at that point compared to past cycles where it's been a lot smoother. And as some of these projects come online, maybe things aren't as continually deteriorating, you know, beyond (2010). And I realize that's a multi-year outlook, but that's one scenario that seems to make sense to me.

Jim Lines: I don't dispute your analysis of the situation. This has been a very quick change. Last quarter seemed as though the entire market had frozen, went into gridlock for credit market issues, the reduction in consumption, which is a short-term issue we believe, the cost of the projects not adjusting to the price of oil. And these are the situations that will modify or change as time goes on. And the wait-and-see attitude I can understand from the end-user's perspective.

Operator: Our next question is from Mr. James Bank with Sidoti & Company.

James Bank: Jim, I believe just sort of piggybacking on the last series of questions, listening to Jacobs Engineering earlier this week—crack spreads are actually climbing. And again, I just wonder if these near-term trends that seem to be so severe. Looking at your order number, is it fair to be optimistic, let's call it eight to 14 months out in refining?

Jim Lines: It's a difficult environment to provide short-term outlook. I know you might think two or three quarters out is in short-term, but from our view, it still is a little unclear to us. Again, being advised that our customers are prepared to wait six to 18 months as the supply chain softens, that makes it less clear for us to predict the turnaround. There will be a turnaround. You are right the crack spreads are widening. I think we are seeing refiners move more toward the production of diesel, which comes into the crack spread. Diesel is more valuable today than gasoline. That does have potentially a positive effect on how a refiner would require our equipment or have to modify existing facilities to produce more diesel versus gasoline. However, at this point in time, providing a quantified view as to when the markets will recover is difficult. But again, I go back to long-term, the demand trend line we don't believe is different long-term.

And while we're in this downturn, I view this has an opportunity. What a company does during the downturn makes the difference when the markets recover. We're going to be aggressive in this downturn to continue to improve our company, to strengthen our sales organization, and use the strength of our balance sheet, where appropriate, to expand our market reach, expand our products. This is an opportunity for a company prepared to go into a downturn, and I believe we are very prepared for the downturn.

James Bank: Jumping across a couple of questions here, let me go into this one. With the share repurchase, I think that's why there's some favor for the stock today. The reason I'm asking this is because you just had split the stock and I think you're able to do it again; clearly not at this price. But it seems a bit counterintuitive to have a share purchase program so quickly in place. Is that really a function of not seeing any good deals out there?

Jim Lines: Well, the deal values will be coming down, we believe, as this downturn goes forward. We also looked at what our cash is, what our expected cash flow from operations will be, and we felt at the Board level this was a strong position by the Board to institute its repurchase program to show the confidence the Board has in our company and the long-term outlook.

James Bank: I guess the quasi-guidance for SG&A costs next year, the $13 to $14 million seems a bit elevated. What's behind that?

Jim Lines: Well, what's behind it is again, I view this downturn as not a time to pull back. I view this downturn as an opportunity to be with our customers, to strengthen our sales organization, to reach new markets, to expand our presence and use this as an opportunity. But I think we did one thing well during the last downturn, which was 1998 through 2004, as we went out and we strengthened our brand; we defined the brand. We went out with a multi-phase marketing program to strengthen our relationships, to position the company to capture more market share during the downturn. So I think pulling back in SG&A, although possible, is not the right strategy entering the downturn with our customer base.

James Bank: Last question. It seems like only three or four months ago I think you guys are running at, I don't know, arguably 105% to 115% of capacity, including the sub-contract work. The other market that you mentioned, fertilizer manufacturing and nuclear was one - I know you guys are able to get into those markets. You were turning a lot of that business away as you were taking the more profitable refining work. How quickly could you switch into that? And I know I'm looking at short-term and long-term a lot more than you, but how quickly can you switch into that should refining not come back until potentially fiscal 2011, 2012?

Jim Lines: For the fertilizer market, as an example, we maintained our presence in that market. There wasn't much being invested in the fertilizer market during 2005 through 2008. We have remained clearly in the market, close to our customers. We have fertilizer opportunities in the pipeline that we would expect to capture. And that's a market we have won in before. We haven't moved away from it. It's an important market. We've remained present in other adjacent petrochemical markets haven't really changed. It was so much demand coming from all the markets 2005 through 2008. We were using our resources as appropriately as we could but did not abandon those markets. I think that's the important point; we did not abandon those markets.

Operator: Our next question is from Mr. Chris McCampbell with Stifel Nicolaus.

Chris McCampbell: Good morning. How sensitive are you all to the price paid in regards to share repurchase? It seems like there's almost a sense of urgency with a six-month window for repurchasing a million shares?

Jim Lines: We really haven't had discussions around the boundaries for the repurchase price. So I really don't have much to offer at this time on that.

Chris McCampbell: I mean obviously trying to buy back a million shares with the stock at, you know, 10 bucks, there's an expectation of purchasing the stock at this price You're not waiting for a lower price or something along those lines I guess is what I'm trying to get to.

Jim Lines: That's accurate.

Chris McCampbell: In regards to the acquisition strategy, are there particular candidates that you have your eye on? Or is there a niche you're trying to fill that you're just kind of waiting for possibility of situations coming to fruition?

Jim Lines: Well, we have an acquisition strategy that addresses the areas that we believe we could expand our market share or increase the level of products that we are providing into a given sales channel or enter new markets. So we're looking at the energy market where we currently are and how we can leverage our brand, leverage our sales channel, to maximize what we can pull out of that market.

Chris McCampbell: Do you think there are some situations that could help with that strategy in the near term, or is this something that may not see anything happen in that next six to 12 months?

Jim Lines: I think this is a time, as we enter into a downturn, that is possibly going to provide some very good opportunities for a company like Graham that's well positioned to take advantage of those opportunities.

Chris McCampbell: Well, I appreciate the fact you have to keep your cards close to your vest. So thanks for the color.

Operator: Our next question is from Mr. Alex Blanton with Ingalls & Snyder.

Alex Blanton: First, I did a quick calculation based on what you said about a 28% to 31% gross margin and a 35% reduction in sales. If we assume $100 million in sales, we take that down to $65 million, use a mid range gross margin 29.5%, that's $19 million. And then subtract $14 million in SG&A, that's about $5 million in operating profit, about 8%. Is that the kind of thing you're thinking of if sales are off 35%, let's say? That level of profitability?

Jim Lines: We would expect to manage our costs roughly within alignment of what you've been given or what you've estimated, trying to drive that profitability higher than what you would back into from that quick calculation

Alex Blanton: Secondly, what you described in terms of the reason for some of these cancellations and so on, it's kind of a deflationary scenario, isn't it? I mean it's the opposite of people ordering quickly in order to avoid price increases. And is it really that, or is there another component, just the reduction in the oil price for these countries causing their cash flow to go down and just not being able to afford those investments at this time? Is that a factor in that, too?

Jim Lines: That probably is. I'd sort of frame it this way. Thinking about where oil was in 2004 when the expansion actually began, it was in the $30 to $40 per barrel range back at that point in time. And there was a very large wave of opportunities that were coming at that time. What occurred, however, was the supply chain tightened, materials escalated, costs to the end-user escalated two-fold, probably between $1^{3/4}$ and 2 times over that timeframe. That was satisfactory while oil was increasing. However, as oil has dropped off, the ROI on the investment gets challenged. And until the supply chain softens and the costs come down - and they will - they need to decide when to reevaluate these projects and get back on stream with them. But long term, they need to satisfy the demand. I view this as a short-term situation. My long-term view has not changed.

Alex Blanton: This is the first time I've been on your conference call. I don't have a clear idea of where you stand in the industry or the particular products that you sell. And I'm not really interested in, you know, your share of a huge market, including a lot of things that you don't sell. But just looking at your served markets, can you give us an idea of your share of that and who your competitors are and also perhaps some idea of how you expect to fare during this downturn vis-à-vis competitors? Are there some smaller ones that will drop out and so on?

Jim Lines: Just very briefly, talking about the key markets. In refining for the vacuum distillation type applications, we believe we have a leading market share in North America. We would believe our market share to be between 50% and 75%. Globally, we believe the market share is between 35% and 50%. We have European competition, and we have a North American competitor for that market sector.

Alex Blanton: Who is that competitor?

Jim Lines: Gardner Denver.

Alex Blanton: And this is what specific product?

Jennifer Condame: Hey you know Alex, why don't we follow up with you, because a lot of this information is provided in our investor presentation.

Alex Blanton: Sure.

Operator: Our next question is from Mr. George Walsh with Gilford Securities.

George Walsh: Jim, I do want to amplify just the comments that you've made. One, in terms of managing the downturn, but also the way you managed the very good part of the cycle in terms of the way you have managed that balance sheet. And then I think that's extremely important. And from an investment perspective now for companies, we are in the age of the balance sheet, I believe. A lot of companies have built up a lot of debt and short-term debt that is getting them into a lot of problems. And you're in a very good position here with cash, and it's three-fold. That helps you with the balance sheet at this point to manage the downturn, to be able do moves like the buyback and do potential mergers and acquisitions.

The one I'd like to focus on, I guess if we could a little bit more, is the merger and acquisition element. What are the real possibilities there that you see? You do mention the goal still that you have of possibly doubling the size of the company over the next several years. Obviously, you know, the growth near term in the cycle is less agreeable to that as opposed to maybe feeling there are some larger opportunities for you in this area. What are the factors that would help speed that up in terms of things you're doing? Or are you just kind of sit back and see how things develop in various markets? Are you more focused on adding to markets that you are in or really approaching certain new markets to get into different parts of the cycle?

Jim Lines: We're focused on addressing, in the energy sector, where the opportunities are for Graham to maximize its brand, to leverage the sales channel more than we currently are, and actually add products to our offering to maximize in the sales channel or to enter adjacent markets that we're currently not fully in or that are still under the energy umbrella.

George Walsh: **W**ould it be such a thing that you're looking for, would it be a series of, you know, relative to your own size, smaller acquisitions, or something that would be comparable to your size? Just even up the pipeline of things you're looking at - is there a variety of sizes?

Jim Lines: In the past, George, on prior conference calls, I've framed it with an upside of—again, it would depend on the valuation—but sales up to as high as $80 million but thinking in terms of $40 to

$60 million. But there could be very fine companies that are below the $40 million. It really will depend upon the fit and the valuation.

George Walsh: Then most of these I guess are private companies?

Jim Lines: Yes.

George Walsh: Would there be a geographic diversification in terms of it?

Jim Lines: That's a part of our criteria that we are evaluating as to a way to complement and extend our market region, strengthen the company for future years.

George Walsh: Well the cycle is a cycle; it's a cyclical business. But once again, I do want to commend you on the management and the strong balance sheet you have there right now, and I think it's very important as you go into this part of the cycle. So thanks a lot.

Operator: Thank you. There are no questions in the queue at this time.

Jim Lines: Well, I thank everyone for their time this morning and your interest in our company. We'll continue to update you on our progress, both with the internal improvements, the market outlook, and our external growth strategies on future conference calls. Thank you.