

**Graham Corporation (NYSE Amex: GHM)  
Second Quarter Fiscal 2010 Financial Results  
Conference Call and Webcast  
October 30, 2009**

---

---



**Operator:** Good morning, ladies and gentlemen and welcome to the Graham Corporation second quarter 2010 quarterly results conference call. It is now my pleasure to introduce your host, Ms. Deborah Pawlowski, IR 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's fiscal 2010 second quarter financial results call. On the call with me today are Jim Lines, President and CEO of Graham, and Jeff Glajch, Chief Financial Officer. Jim will briefly review the second quarter's performance and will discuss the company's strategy and the outlook, as well as his perspective on the state of the industries we serve, while Jeff will be reviewing the company's performance in the recent quarter and first half of the fiscal year.

You should have a copy of the earnings release that was put out this morning, and if not, you can access it at the company's website, which is [www.graham-mfg.com](http://www.graham-mfg.com). In addition, we have posted supplemental slides on the website to provide a visual overview of our results. 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 was 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 both at the company's website and at [www.sec.gov](http://www.sec.gov).

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

**Jim Lines:** Thank you, Debbie, and welcome, everyone, to our conference call for the second quarter fiscal 2010. Sales in the quarter at \$16 million were in line with our expectations. However, they were down sequentially 20% and down 33% year-over-year. Our margins held at relatively high levels with the amount of sales in the quarter. I believe that maintaining gross margin at 36.3% and operating margin of 17.5% demonstrates that our managers and the entire company have been able to control costs while sales have sharply declined. The steps our employees took to improve the company during the upturn that resulted in record financial performance for fiscal years 2008 and 2009 are showing through in the downturn. The Graham team demonstrated that it could execute differently than it did during prior strong markets. Now, equally importantly, they are demonstrating that Graham is also a different company in a sharp downturn, arguably the worst downturn since the 1930s.

I believe that the actions taken over the past few years that enabled Graham to grow during the past cycle have also been instrumental in allowing the company to execute well and remain profitable during the current downturn. These actions include an ongoing, company-wide commitment to continuous improvement; investment in IT and process improvements; investment in the low volume, high mix Graham production system by investing in both process flow and equipment; policy deployment and performance management; value-based selling; and a renewed commitment to improving customer relations. We intend to continue to invest in the company, its employees, process improvement and IT and production equipment in eliminating waste, and in becoming a faster company. We believe these steps were critical to Graham's ability to manage profitably across this sharp downturn and are essential to staying competitive in the future. I believe we can remain profitable at the bottom of the cycle, which we expect to be in the next few quarters. Our strategy throughout the downturn has been to be ready for the market recovery. We expect that this strategy will allow us to take market share from our competitors, expand our markets, and ultimately grow more quickly than we did during the past growth periods.

We implemented additional restructuring in September as a result of our outlook across the next several quarters, which we believe for Graham will represent the bottom of the downturn. In total, we have completed two restructurings, the first in the fourth quarter of fiscal 2009 and the second in the last

---

---

quarter, which together lowered our annual costs by approximately \$4.3 million. Some of this cost reduction was in SG&A; however, the majority, about 75%, was in cost of goods sold. I expect that following these restructurings the company will have more than sufficient capacity to capitalize on opportunities in our markets while at the same time maintain a cost structure that supports profitability during the remainder of the downturn.

New orders in the second quarter were just under \$30 million. This represents an excellent improvement from the \$8.8 million of bookings in the first quarter and is our highest bookings quarter since the fourth quarter of fiscal 2008, which was before the global recession set in. In the second quarter, two major refining projects in the Middle East moved forward with equipment purchases that represented about half the bookings in the quarter. I believe that there is more opportunity for Graham on each of these major projects.

We felt market recovery would be led by Asia and the Middle East, followed by South America and then by the North American market. That is what we believe we are seeing now. We are encouraged by the advancement of the projects in the second quarter. While bookings in the quarter were strong and our perspective on the pipeline continues to improve we do not believe our markets are in full recovery. We expect that order rates in subsequent quarters will continue to be non-uniform and vary significantly on a quarter-to-quarter basis. We intend to continue our aggressive but disciplined approach to winning new orders.

We are tightening our revenue guidance for fiscal 2010 to \$60 to \$65 million. This is due in part to the suspension of a large project that had been planned to be completed across the third and fourth quarters. Although this project has not been cancelled, it has moved into fiscal 2011. Jeff will update you on our margin guidance.

In summary, this downturn has been dramatic and fast. We intend to continue to be proactive in our response to the downturn while at the same time keeping our commitment and focus on where we want to be in the next growth cycle from a productivity, cost, product breadth, and operations perspective. We intend to be ready when our markets do recover.

Let me turn it over to Jeff for a greater detail on the quarter.

**Jeff Glajch:** Thank you, Jim, and good morning, everyone. I will start with a review of sales and operations activity before moving on to our orders and backlog. Net sales in the second quarter of fiscal 2010 were \$16.1 million, a \$7.8 million decline compared with last year's second quarter and down \$4 million from the trailing first quarter of this fiscal year. As expected, Graham's sales have begun to shift toward international and away from the U.S. market. Second quarter fiscal 2010 sales were split equally between the international and U.S. market compared with 63% of sales in the U.S. in last year's second quarter. U.S. sales declined \$6.8 million, or 46%, to \$8.1 million while international sales declined just \$900,000, or 10%, to \$8 million.

In the quarter, sales to Asia were \$4 million, up from \$1 million in last year's second quarter. This continues the trend from the first quarter. For the first half of this fiscal year sales to Asia have tripled to \$12.2 million, up from \$4 million in the first half of fiscal 2009. Sales in the Middle East in the second quarter were comparable to last year at \$2.9 million, off just 3% or \$100,000. Sales in all other regions, South America, Europe, and Canada, offset the gains achieved in Asia in the second quarter.

For the first half of fiscal 2010, net sales were \$36.2 million, nearly 30% below last year's first half sales of \$51.6 million. In this period U.S. sales made up 51% of total sales and international sales accounted for the remaining 49%. These percentages for the prior year's first half were 65% U.S. and 35%

---

---

international. Again the increase in sales to Asia and the slower U.S. market accounted for the majority of this trend toward an increase in international sales weighting.

As Jim mentioned, based on the geographic source of our orders and the activity of the various energy industries that we serve in those regions, we continue to expect to see our sales mix shifting toward Asia and the Middle East and away from the United States. By industry, while sales dollars have declined across all segments, as expected, we continue to see a shift away from refining, especially in the United States. Sales to refiners were down to 44% of total sales in the second quarter of this fiscal year compared with 47% in the same period last year. 33% of sales were to the petrochemical industry, up from 27%, and 23% of sales were to the power and other industrial applications, down slightly from 26% last year.

For the first six months of fiscal 2010, refining industry sales accounted for 45% of total sales, down from 50% of total sales in last year's first half. Petrochemical sales in the first half of 2010 increased to 28%, up from 23% last year, while sales for power and other industrial applications stayed constant at 27% of total revenue.

Orders in the second quarter of fiscal 2010 were \$29.6 million and were at the highest level since the fourth quarter of fiscal 2008, 18 months ago. International orders totaled \$23.4 million and accounted for 79% of the second quarter orders. This was driven largely by the Middle Eastern orders that Jim mentioned earlier, which made up just over half of the total for the quarter. As we have mentioned in the past, we expect quarterly orders during this disruptive period in the cycle to be quite erratic, and we suggest using trailing 12 month information to understand our order trends.

At the end of September 2009, backlog was \$50.5 million, a \$13.5 million improvement from the backlog of \$37 million at the end of June 2009. It is important to note that we expect only 65% of this existing backlog to ship within the next 12 months. Our historical 12 month shipment expectation is usually 85% to 90% of backlog; however, because a significant portion of the \$16 million in orders that we announced in a separate press release today are not expected to begin to ship until the latter half of fiscal 2011 and into fiscal 2012, our backlog has become more extended.

The measurably improved backlog is net of a cancelled \$500,000 order that had been on hold. In total our backlog includes \$7 million in orders on hold related to suspended projects. This number was \$4.2 million at the end of June, but along with cancelling the \$500,000 order just mentioned, we added a \$3.3 million project to the on-hold status in this most recent quarter. This \$3.3 million project was originally expected to ship this fiscal year. However, it is now expected to ship in fiscal 2011.

Given our backlog and general business conditions, we are projecting revenue for the full fiscal 2010 to be between \$60 and \$65 million. Our gross margin continued to be relatively strong in the second quarter given our level of sales. Gross profit was \$5.9 million, or 36.3% of sales, compared with \$10.5 million, or 43.9% of sales, in last year's second quarter. For the first half of fiscal 2010 our gross profit was \$14.1 million, or 39% of sales, compared with \$22.7 million, or 44.1% of sales, in last year's first half. Based on the strength of our gross margin in the first half, we have increased our full-year gross margin guidance as a percentage of sales to be in the range of 33% to 35%. And yes, when you do the math you will find that the second half gross margin will be measurably lower than the first half, in the mid- to high-20s. This is due to the expected level of revenue in the second half as well as our belief that we will not have as much opportunity on the purchasing side to expand those margins as we had in the first half of fiscal 2010.

For the second quarter of fiscal 2010, SG&A expenses were \$3 million, or 18.1% of sales, compared with \$3.9 million, or 16.4% of sales, in the second quarter last year. For the six-month period, SG&A expenses were \$6.3 million, or 17.3% of sales, compared with \$7.8 million, or 15% of sales, in last year's

---

---

comparable period. The restructuring initiatives we have undertaken, both at the end of fiscal 2009 and more recently in the second quarter of fiscal 2010, combined with lower commission costs, related to the decline in sales, account for the reduction in SG&A dollars in the current fiscal year.

We expect SG&A for fiscal 2010 will be in the \$12.5 to \$13.0 million range, down from our previous estimate. Keep in mind that while our two restructurings are expected to yield a total of \$4.3 million in savings, \$2.7 million from the initial measures we undertook in the fourth quarter of fiscal 2009, and an additional \$1.6 million from this most recent quarter's initiatives, most of the benefits, around 75%, have and will continue to impact manufacturing cost instead of SG&A.

Interest income in the second quarter of fiscal 2010 declined to \$15,000 compared with \$172,000 in the same period last year as a result of the significant decline in U.S. treasury yields. Our investments are in U.S. Treasury securities with maturities up to 180 days.

Our effective tax rate in the second quarter was unusually high at nearly 46% due to a \$435,000 charge related to income tax credits that Graham claimed for the 2006 to 2008 tax years. This charge is our best estimate of the potential credit reversal from these claims. In addition, there was a \$32,000 interest charge related to the incremental tax estimate. We are currently in discussions with the IRS over this issue and believe our tax position is correct as originally filed. Without the charge, our effective tax rate would have been slightly under 30% in the quarter. Excluding the charge, we estimate our effective tax rate for fiscal 2010 will be between 30 and 31%.

Net income in the second quarter of fiscal 2010 was \$1.5 million, or 67% below last year's second quarter. On a per-diluted share basis, earnings were \$0.15 compared with \$0.43 last year. Excluding the charge associated with the prior R&D credits, which netted to \$0.05 per diluted share, net income was \$1.9 million, or \$0.19 per diluted share. For the six-month period, GAAP net income was \$5 million compared with the first half of last year's net income of \$10.1 million. Excluding the charge for the tax credits, first half net income was \$5.5 million, or \$0.54 per share.

Graham's balance sheet remains strong with cash, cash equivalents, and investments totaling \$54.7 million at the end of September, up from \$45.3 million at the end of June, and \$46.2 million at the end of fiscal 2009. For the first half of fiscal 2010, we generated \$9.3 million from operating activities and increased our cash and investments position by \$8.5 million. The cash generation in the first half of fiscal 2010 resulted from a combination of strong operating income, despite the market downturn, and continued improvements in working capital.

Excluding cash, cash equivalents, and investment, our net of current assets less current liabilities is minus \$162,000. We have no borrowings on our \$30 million bank line and are utilizing it solely for outstanding letters of credit, which totaled \$9.9 million at the end of the second quarter. Capital expenditures were \$202,000 in the second quarter of fiscal 2010 and \$394,000 in the first six months of this fiscal year. We continue to pursue our capital plan which is an important part of our internal development activities and estimate that total capital expenditures for fiscal 2010 will be approximately \$1 million and half of that investment is planned for productivity improvements.

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

**Jim Lines:** Thank you, Jeff. At this time we will take your questions.

**Operator:** Thank you, ladies and gentlemen. Our first question comes from the line of Rick Hoss with Roth Capital Partners. Please proceed with your question.

---

---

**Rick Hoss:** I just wanted to get a little bit more detail on the \$16 million of that \$29.3 in bookings that you have discussed. You talked about the majority being two projects in the Middle East. Are you able to comment if one of those is associated with Jubail and/or Yanbu?

**Jim Lines:** It's associated with both projects. We have a little piece of business in both projects and more importantly we think there's more opportunity for us on each project.

**Rick Hoss:** Are you able to comment on what you think the total potential from each of these projects could be?

**Jim Lines:** Each is about 400,000 barrel per day refinery. In total across both refineries, we would think in terms of \$25 to \$35 million of total opportunity for us.

**Rick Hoss:** Second question: At what revenue would you have to start adding to SG&A? I'm viewing this quarter's SG&A as probably your bottom or close to bottom. Where would you have to start adding people?

**Jim Lines:** We've tried to keep in mind that we want to build this company to take advantage of the opportunities in the future. We didn't scale back appreciably in the SG&A area. There are some variable expenses in SG&A tied to the level of sales, so without personnel additions SG&A could increase as revenue increases. There's a proportionate increase in our commissioned sales as revenue goes up. We think we're adequately staffed to take advantage of the opportunities that would be in front of us over the next one to two years with our staffing in the sales area.

**Rick Hoss:** Okay, so expect some pretty decent levers then on revenue growth?

**Jim Lines:** We believe so, yes.

**Rick Hoss:** Can you describe the phasing of your projects, the recognition of your projects today compared to a year and one-half ago? What I'm trying to get at is it seems like you're able to ship projects earlier than the last several years, and that does go from a nine to 12 month target to maybe a six to nine month? And this excludes that \$16 million that we've already talked about.

**Jim Lines:** We segment our business a number of ways, but the two key ways would be larger projects and smaller projects. We've indicated that around 40% of our sales in a given year would be smaller projects, which tend to convert within one to three months after the order. And then for the larger projects that have order announcements, (press releases) that will depend upon the type of project. If it is a refining project, Rick, we are still seeing schedules between 12 and 18 months on average from order to complete shipment, bearing in mind that revenue could occur over the last six to eight months of that timeframe. For a power generation job or a petrochemical project, that could be in the 10 to 14 month timeframe. So it really will depend upon the type of order that we're winning and the value of that order with regard to how quickly it begins to convert to revenue.

**Rick Hoss:** And the last question for Jeff. Do you have any updates on the acquisition search? How are valuations looking, and is there any change to the strategy?

**Jeff Glajch:** Rick, let me answer your last question first. No, there is no change in the strategy. We certainly have been spending a good deal of time looking at opportunities and also valued a number of opportunities. We haven't come to what we felt was the right opportunity at the right value yet.

With regard to valuation, they seem to be stabilizing a little bit. Certainly in the private markets it took a little longer for the valuations to come down than in the public markets, but I think we're at a pretty good

---

---

base right now. But, at this point we have not identified an opportunity that strategically is the correct thing for us at a value that we're comfortable with. But we are certainly very busy.

**Operator:** Thank you. Our next question comes from the line of Tom Lewis with High Road Value Research. Please proceed with your question.

**Tom Lewis:** Good morning. First question: As the company has been through a few cycles, what can you tell us about the orders postponed? You mentioned one that was cancelled. Is this something that would be normal during a cyclical downturn? It's happening at a normal rate or is it in line with your comment about the worst downturn in a very long time?

**Jim Lines:** The downturns, when you're in them, Tom, always feel brutal. They tend to, from my experience and I've been through three, be pretty similar. This time around though, some of the refining work actually was cancelled or put on suspension. If I recall correctly in the prior downturns, we would get a little bit of it. But because of the expansiveness and the swiftness of this contraction, some projects were cancelled that we didn't expect to be cancelled based on our historical perspective of going into a downturn.

**Tom Lewis:** When a project cancels, do you tend to have anything in there other than some sales type consultation or do you book any revenue at all early on in the design process?

**Jim Lines:** Our revenue cycle begins when we begin production. In negotiating contracts we tend to negotiate cancellation schedules that protect the company so that in the event a project is cancelled, we have our costs covered that we've put into the project and perhaps some opportunity costs on the future profits that we would have earned. But that really depends on the situation.

Invariably those are negotiations between us and our customer. There we look to maximize a given opportunity. We look to maximize the relationship over the long term, so we are a flexible company when we're talking about cancellations with our customers.

**Tom Lewis:** You mentioned, in referring to your order pipeline activity, that your perspective had improved. Were you just speaking with respect to how clear your perspective was or were you speaking to the improvement in the long-term likelihood of opportunities, or both?

**Jim Lines:** Our customer-facing groups, our sales team and our application engineering group, have been very pleased with the level and quality of the activity that they're seeing come from our customers. Now, we have remained very busy over the last 12 to 18 to 24 months, not too different from how busy we were in those areas two years ago and beyond. But the quality of the work, the perception that the projects are beginning to advance, our customer-facing groups feel the quality of that work is improving, and they're very optimistic about the nearer term than they were six to nine months ago.

**Tom Lewis:** So based on that, if we think about your business over the next five or so years, two years ago was probably well above normal. The next few quarters are well below normal. Do you think that however "normal" ends up over the five years closer to the one or to the other?

**Jim Lines:** Inherently being a provider of equipment to the energy markets we will be a cyclical business. What we're projecting, and it's our belief, is that our company can grow. We believe we can grow more rapidly than we did during the last up-cycle, and our expectation is that we can grow beyond where we reached last cycle. But we're not saying that we won't have the cyclical pattern. Hopefully not as extreme as what we just went through, but we will be cyclical. So it's hard to give you a comment on what is a "normal" level of business, but I can state that it's our expectation that our company is prepared

---

---

to grow when the markets recover. We believe we can grow more quickly than we grew in the last cycle, and it's our expectation that we'll grow beyond where we grew in the last cycle.

**Operator:** Thank you. Our next question comes from the line of Chris McCampbell with Stifel Nicolaus. Please proceed with your question.

**Chris McCampbell:** Congrats on managing the business in this environment. It's really impressive. Rick asked a lot of the questions I wanted to ask, but should cash generation be more muted for the remainder of the year in comparison to the second half, or would that be similar?

**Jeff Glajch:** We expect that cash generation will be more muted in the second half of the year. If you look at our cash generation in the first half, it was driven primarily by our earnings in the first half as well as some improvements in working capital. We think the improvements in working capital probably will not be repeated. And on the earnings side if you run out the guidance that we provided, you'll see that our second half earnings would be significantly lower than the first half earnings. So we don't expect a lot of cash to be generated in the second half of the year, although we also do not expect to be using cash for operations.

**Chris McCampbell:** And could you give any additional color on acquisition candidates out there? I mean, are you leaning more toward things that would diversify a little bit away from the business that you have going on now, or are we looking to focus on adding to what we have already?

**Jeff Glajch:** We are looking at two avenues. One avenue is looking at expanding our product line and potentially expanding into some markets that we currently play in but maybe aren't as strong in as we are in refining and petrochemical. So that avenue would be expanding the breadth of our product line and giving us some additional opportunities, and potentially being less cyclical or somewhat counter-cyclical to our existing business.

The second opportunity is looking at geographic expansion, which would be to have fabrication and engineering capabilities somewhere outside the U.S. to take advantage of some specific markets that are out there. That would be more in line with our existing business, but it would also, by focusing on other markets and potentially being able to get deeper into some of those other markets, help with the cyclicity a little bit, too.

**Chris McCampbell:** From a geographic perspective would you say that domestically you are having any conversations with your customers in regards to cap and trade and potential environment that you would have here? Are people postponing decisions based on the regulatory rhetoric or is that having any effect at all?

**Jeff Glajch:** I think the domestic market we have viewed, even without the cap and trade of legislation, as being slow in the next couple of years. It was very strong for a number of years. We believe it's slowed down now, and I think the cap and trade legislation is putting a level of uncertainty into the process because it's not clear exactly where that's going to land. But we don't think it's affecting near-term decisions. It certainly could have an impact on longer term decisions.

**Operator:** Thank you. Our next question comes from the line of James Bank with Sidoti & Company. Please proceed with your question.

**James Bank:** The first question is regarding that cancelled project, that was just \$500,000 - \$700,000?

**Jeff Glajch:** Correct. It was \$500,000.

---

---

**James Bank:** And then the one that's on hold, is there a particular reason for that, maybe pricing? Are they trying to renegotiate the contract or anything like that?

**Jim Lines:** No, it has to do with some engineering activity that they have to complete and it's working with the EPC contractor to finalize that.

An important point I want to make is that it's not a project for transportation. It is a refining project, not for transportation fuel, but for high quality lubricating oils for improving engine efficiency. So it's not a project tied to supply and demand per se.

**James Bank:** Now, with raw material inching up a little bit, a 33% to 35% gross margin, is that sustainable as we get into next year, or are we going to need to see a big uptick in volume, do you think?

**Jeff Glajch:** The 33% to 35% is our full year number and includes the year-to-date gross margin, which is at a higher level than that. So if you were to do the math, you'd get into somewhere in the mid- to high-20s for a gross margin in the second half of the year. And recognize that is also on a lower level of sales in the second half of the year than the first half of the year. We would think at that level of quarterly or half-year sales, the mid- to high-20s is probably the place that we would be when we get to the point where the revenue number starts increasing, there's a significant amount of leverage there from a margin standpoint, and we would think we would start seeing the margin going up from that mid-to high-20s range. We think the mid- to high-20s is the trough margin at this point in time. And again, we expect that to be the range we're in, in the second half of this fiscal year.

**James Bank:** On the backlog side, it looks like some shipment of some higher margin stuff has helped just a little bit more here in the quarter, not down a lot from where we were in the first quarter. Is that pretty much it for those price inflated projects from the last cycle?

**Jim Lines:** Yes, James, that works through the backlogs. But going back to what we mentioned on the last conference call, an appreciable portion of the margin lift that we saw in Q1 and the margin we had in Q2, I would say, has been attributed to lower cost materials and being able to take advantage of how we procured materials during this downturn. That appreciably lifted our margins.

**James Bank:** Well why wouldn't we see that same type of success in the back half? Has raw material moved too quickly at this point to continue to take advantage?

**Jim Lines:** We'll continue to be as disciplined as we were in Q1 and Q2. It's hard to suggest that you should model the business around continuing to have those savings because it really will depend on how the market recovers and how the supply chain tightens up. Our team has been able to find opportunities where there has been available capacity, aggressive negotiations, and flexible suppliers that we would attribute to where the supply chain is at that point in time.

**James Bank:** On the cost savings, 75% of that's been realized, and you would say most of that is going to be in the manufacturing cost end?

**Jeff Glajch:** No. Of the \$4.3 million, about 75% will be in the cost of goods sold side, and the \$2.7 million annualized number that we did in the restructuring in the fourth quarter of fiscal 2009 has been realized on an annualized basis. The \$1.6 million which was related to the restructuring that we just did within the last fiscal quarter, we're just starting to realize now.

So we really did not realize any of that \$1.6 million in the second fiscal quarter, but we'll start seeing it in the third fiscal quarter.

---

---

**James Bank:** Jim, if you did \$100 million in sales what do you think your SG&A would be?

**Jim Lines:** Comparable to what it was when we did \$100 million last time.

**Jeff Glajch:** Which was around \$15 million.

**James Bank:** So no leveraged benefit in SG&A?

**Jim Lines:** To be candid, we have a little more SG&A expense now, but that's necessary to take advantage of where the sales will come from, which would be the emerging markets. We needed to strengthen our sales organization to take advantage of those opportunities. It's not appreciable, James, but there is more cost in our SG&A to go after the business where it's going to come from in the future.

**James Bank:** For modeling purposes we should drive it with whatever a hypothetical sales number would be and just assume if it's up, commission dollars are up, and if it's down, commissioned dollars are down and just run it through that way.

**Jim Lines:** That's a good way to model it.

**James Bank:** \$30 million in orders, I understand it's volatile but that's quite a big number. You can almost assume \$38 million in the first half, which could give you a pretty good run rate for the full year. Are you not issuing press releases for these orders anymore intra-quarter?

**Jim Lines:** Yes, we are. The orders came in at the end of the quarter. Near the last half of September a good amount of them came in, and it was timing of wrapping up the quarter and getting ready to release the announcements.

**Jeff Glajch:** Specifically those larger orders came in late in the quarter.

**Jim Lines:** But to be clear, we haven't changed our philosophy on announcing larger projects.

**James Bank:** I think on the last conference call at the end of July I think you gave us a rough aggregate of the orders that you had booked. Could you do that for us for the month of October?

**Jim Lines:** The orders that have been won in October are between \$5 and \$6 million.

**Operator:** Thank you. Our next question comes from the line of George Walsh with Guilford Securities. Please proceed with your questions.

**George Walsh:** I'd also like to add my congratulations to you, Jim, and the whole team for doing a very good job of marketing during the entire business cycle. It's quite a feat in the very, very volatile market you've had to deal with.

But I'd also like to look forward a little bit, and you touched on it here in the last question. It really looks like it would be a foreign-sales-led recovery that you're looking at. And you partially touched on the idea that there would be some more sales and marketing types of investment you'd need for those type, you know, to fully exploit that. I wonder if you could just go into other expenses or how that cycle might be different for you because I think this would be the first that I've noticed a really foreign-led sales cycle potentially in terms of dominance in revenue for Graham. So would that mean you'd be outsourcing more from Batavia versus doing the manufacturing there or as you would other type of investments you do in ramping up your sales and marketing, or any other factors you might see?

---

---

**Jim Lines:** Good question. To a large extent the same EPC contractors that we work with for domestic work are pursuing the international work. We'll get orders from, for example, Fluor or KBR, just as we did in the past cycle that were for the U.S. market, but now it's for the international market. Managing that same sales channel hasn't really changed. As international contractors begin to take more of the market share, Japanese, Korean, and even some Chinese contractors, that changes how we have to manage those relationships.

But within our cost structure that we have now, I think to a large extent, we thought this was going to occur. We could see it coming in our future, and we have organized our sales team both from a headcount and a structure perspective to be prepared for this. We felt the recovery would be coming from the emerging markets, which would be China, the Middle East, and South America. Our proposal activity over the last 12 to 18 to 24 months has been largely for those areas, and I think our channel and our opportunity management prepared the company well, I believe, to be in a position to take advantage of those opportunities when our customers were ready to place orders.

**George Walsh:** Jim, just to clarify for my own mind, if I understand it correctly, a lot of your domestic sales anyway will end up with overseas customers. So is the difference with foreign sales that, as you explained, you're dealing more with a foreign contract or as opposed to a Jacobs Engineering, a domestic contractor?

**Jim Lines:** The way we define an international sale, it's based on the end-use location, not necessarily order origin.

**George Walsh:** And the other would be a question regarding cap and trade which you addressed earlier, but the other side would be is this something that would be potentially good for your business in that it could create demand because of regulatory emission issues with your customers?

**Jim Lines:** Yes, there have been in the past when legislation came down from the government, whether it was MTBE, or ultra low sulfur diesel, that created mandatory CAPEX for the refiners to comply with those requirements, that then created demand for Graham's products, whether it was our heat transfer products, or ejector systems, or our surface condensers. So here, too, cap and trade could provide opportunity for us depending upon what processes have to be added to the refinery to comply or to try to manage their costs under that new legislation.

**George Walsh:** Anything that would affect you personally or just in any way that you could think of so far that any of these carbon credits would have an impact on Graham, either for your customers or your customers dealing with you, or for Graham itself?

**Jim Lines:** Nothing that jumps out at us. As Jeff indicated, there's some uncertainty around how this is going to be applied, what the actual amount of carbon tax will be and how it's going to be applied. Couple that with the reduction in the consumer demand in the U.S. market, utilization rate for the refiners being down appreciably, and then the differential between sweet and sour crude closing, these have all had an impact on near-term investment decisions in the U.S. When we look beyond the U.S. there is still investment going on in the Middle East and China, and then we think there will be investments coming out of South America shortly that will be for new refining capacity. As I said earlier we've been managing that sales opportunity for 12 to 18 months in anticipation of when those opportunities would move toward purchase.

**George Walsh:** I know it's vague on cap and trade at this point. I just wanted your best read on that. Thanks a lot.

---

---

**Operator:** Our next question comes from the line of James Bank with Sidoti & Company. Please proceed with your question.

**James Bank:** Just a quick follow-up on the first series of questions. Jim, you mentioned Jubail. I'm sorry, what was the other refinery?

**Jim Lines:** Yanbu, Y-A-N-B-U.

**James Bank:** I think Jubail had been a \$12 billion contract and it's now \$9.6 due to some raw material stuff. Do you know what the total aggregate of the Yanbu project is?

**Jim Lines:** I do not, offhand. Both are 400,000 barrel per day refineries. I would assume it's in that \$10 to \$12 billion range.

**James Bank:** I think that's the first I've heard you talk about South American markets, unless I'm mistaken. What type of work are you seeing down there?

**Jim Lines:** It would be refining and petrochemical work. We've had a long history with the state-owned refiners in Colombia, Ecopetrol; Brazil, Petrobras; PDVSA in Venezuela. We have had equipment in those refineries for decades, and we have our sales people in South America this week interacting with our state-owned refining customers.

**Operator:** Thank you. Ladies and gentleman, we have no more questions at this time. I'd like to turn the floor back to management.

**Jim Lines:** Well, thank you for your time this morning and we look forward to updating you after the end of the third quarter in January. Have a good weekend.