Operator: Greetings and welcome to the Graham Corporation Second Quarter Fiscal Year 2017 Financial Results Call. At this time, all participants are in a listen-only mode. An interactive question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Ms. Karen Howard, Investor Relations for Graham Corporation. Thank you. You may begin.

Karen Howard: Thank you, Matt, and good morning, everyone. Thank you for joining us to discuss the results of Graham's fiscal 2017 second quarter. We certainly appreciate your time today. You should have a copy of the news release that crossed the wire this morning detailing Graham's results. We also have slides associated with the commentary that we're providing here today. If you don't have the release or the slides, you can find them at the company's website at www.graham-mfg.com.

On the call with me today are Jim Lines, our President and Chief Executive Officer, and Jeff Glajch, our Chief Financial Officer. Jim and Jeff will review the results for the quarter, as well as our outlook. We will then open the lines for Q&A.

As you are aware, we may make some forward-looking statements during this 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, which could cause actual results to differ materially from what is stated on the call. These risks and uncertainties and other factors are provided in the earnings release and in the slide deck, as well as with other documents filed by the company with the Securities and Exchange Commission. These documents can be found on our website or at www.sec.gov.

I also want to point out that during today's call, we will discuss some non-GAAP financial measures, which we believe are useful in evaluating our performance. You should not consider the presentation of this additional information in isolation or as a substitute for results prepared in accordance with GAAP. We have provided reconciliations of comparable GAAP to non-GAAP measures in the tables accompanying today's earnings release.

And with that, I'm going to turn the call over to Jim to begin. Go ahead, Jim.

James R. Lines: Thank you, Karen. Good morning, everyone, and welcome to our second quarter conference call. Jeff and I will update you on our performance in the quarter and on our outlook. Please refer to slide three. Our crude oil refining and chemical markets remain contracted and, as a result, revenue in the second quarter of $21.1 million was down 7% compared with the same quarter last year.

Also negatively impacting the second quarter was a decline in short-cycle sales, which includes aftermarket. Aftermarket and short-cycle sales in the second quarter were down approximately 20% compared with last year and fiscal 2015. Nuclear market sales were up, as we began to convert certain larger orders in backlog.

Net income in the quarter was $1.3 million, or $0.13 per share. Income in the quarter was positively impacted by insurance proceeds. Orders of $24.8 million were up 20% compared with same quarter last year. Approximately 45% of orders in the quarter were as a result of diversification strategies pertaining to commercial nuclear power and naval nuclear propulsion markets.

We secured another large U.S. order in the quarter for the Navy industry. That is consistent with our stated goal to be a supplier to the submarine and aircraft carrier programs. Backlog at quarter-end of $104 million continues to be strong.

I now refer to slide four. Sales to crude oil refining and chemical/petrochemical markets, along with those to defense and other markets, were down in the quarter. This decline is reflective of order patterns over the past few quarters for both the refining and chemical markets, and due to backlog conversion timing for our naval work. Sales to the power market were up 100% compared with last year. Domestic sales were more than two-thirds of total sales, which is fairly consistent with the past few quarters and with our expectations.

Jeff, let me turn it over to you for a more detailed review of the results in the quarter. Jeff?

Jeffrey F. Glajch: Thank you, Jim and good morning everyone. If you could turn to slide six, sales in the second quarter were $21.1 million, down 7% compared with $22.8 million in the second quarter last year. Sales in the quarter were 73% domestic, 27% international. In last year's second quarter, the sales split was 67% domestic, 33% international. Domestic sales increased slightly, by 1%, to $15.4 million, while international sales decreased by 25%, to $5.7 million.

Gross profit decreased to $5 million, down from $7.1 million last year due to lower margin orders in backlog, a significant drop in short-cycle sales and lower production volume. Gross margin dropped to 23.7%, down from 31.3% last year. Last year's margin was favorably impacted by productivity improvements as we neared the completion of the CVN 79 project, as well as a vendor settlement which occurred within that quarter.

Adjusted EBITDA margin decreased to 11% from 15% in last year's second quarter, driven by lower gross profit margins. SG&A spending was down in the quarter by $1.1 million, or 25%. Approximately two-thirds of this reduction was due to the benefit of insurance proceeds received within the quarter, with the remaining one-third due to cost reduction programs completed over the last 12 months.

Adjusted net income decreased to $1.4 million, or $0.14 a share, down from $2 million,or $0.20 per share. The net income number was adjusted for a $53 thousand after-tax impact due to the completion of our restructuring, which had begun in the previous quarter. If you recall, most of the charges occurred in the first quarter and I noted during the July call that we would have a small amount of charges hitting this quarter as well.

Looking at slide 7, sales in the first-half of fiscal 2017 were $43.5 million, down 14% from $50.4 million in the first half of last year. Year-to-date sales were 73% domestic, 27% international, compared with 65% and 35%, respectively, last year. Domestic sales decreased $1.1 million to $31.7 million this year. International sales were $11.8 million, down from $17.6 million last year.

Year-to-date gross profit decreased to $9.1 million from $15.2 million in the prior year. And year-to-date Adjusted EBITDA margins were 8%, down from 15% in the first half of last year. Net income, adjusted for the restructuring charges which occurred primarily in Q1, was $1.8 million or $0.19 a share, down from $4.3 million, or $0.43 a share last year.

Looking at slide 8, we continue to have positive operating cash flow. In the first half of the year we generated $3.3 million, of which we paid $1.7 million, approximately half, to our shareholders in a dividend. Our cash balance is up $1.2 million from the end of the fiscal year to $66.3 million, or just under $7 per share. Capital spending has been very light this year, year-to-date at only $200 thousand compared with $500 thousand in the first-half of last year. We expect full-year capital spending to be between $500 thousand and $1 million.

Next, Jim will complete our presentation by discussing the market outlook and updating our full-year guidance.

James R. Lines: Thank you, Jeff. Please refer now to slide 10. Trailing-twelve-month orders by market provides context for the extent of the decline in our traditionally strong oil refining and chemical/petrochemical markets. Refining and chemical/petrochemical markets orders on a trailing-twelve-month basis are down approximately 30% and 50%, compared with trailing-twelve-month orders at the end of the second quarter for fiscal 2016 and for fiscal 2015 respectively.

Importantly, orders from our nuclear power and naval nuclear propulsion markets comprise approximately one-third of the $78.8 million in trailing-twelve-month orders at the end of the second quarter. The importance of strategy executed to enter new markets is abundantly clear. Without those orders from markets we were not in prior to fiscal 2010, today would be a punishing period for us. The bidding pipeline is holding at between $600 million and $800 million on a trailing-twelve-months basis. However, conversions to orders still remain slow.

On to slide 11, we have built a terrific backlog of work that stood at $104 million on September 30th. Due to the strength of our diversification strategy, approximately 60% of backlog is from new markets, not served prior to 2010. Furthermore, due to the magnitude of our naval market backlog, backlog conversion to sales is more extended, with 50% to 55% planned to convert during the next 12 months, 5% to 10% planned to convert in 12 to 24 months, and 35% to 40% converting beyond two years from now.

I'd now like refer to the guidance slide. We've tightened upward revenue guidance to be between $85 million and $95 million. We've lowered gross margin guidance to 21% to 23%. This is due to the forecasted level of short-cycle, including the aftermarket, sales in the second half of the year. New orders for short cycle work were off in the first half of this year, and we project that this will carry into the second half of the year. The gross margin from aftermarket is strong, which isn't a surprise. And with less weighting from the aftermarket and other short cycle work in the second half of the year, we must project a lower gross margin. SG&A is projected to be between $15 million and $15.5 million. Full year effective tax rate is anticipated to be between 30% and 31%.

With these brief remarks, Matt, please open the line for questions. Thank you.

Operator: We will now be conducting a question-and-answer session. Our first question comes from Paul Dircks from William Blair. Please go ahead.

Paul Dircks: Good morning, guys. This is Paul Dircks. How are you today?

James R. Lines: Good morning, Paul.

Jeffrey Glajch: Good morning, Paul.

Paul Dircks: Thanks for taking my questions here. First one, Jim, can you talk a little bit about the changes you've seen in the short cycle market over the course of the first half of 2017. At least in our opinion, that's one of the biggest variances between the last quarterly call and this one, and obviously your outlook for the balance for this fiscal year. Can you talk a little bit about how that market has played out? How that's varied from what your initial expectations were, and how you see it trending from this point forward?

James R. Lines: Paul, that's a very good question. We have seen some slowing in that segment of our business. It started to materialize more pronounced in the second quarter from a bookings point of view, and some of those orders do come in and out in the quarter. So, therefore, we began to see a slight decline. The extent of decline is a bit unexpected. We don't feel it's of a long duration. We think it will begin to recover. We haven't begun to see that yet. However, we don't believe that it's a long-term impact; it's more transitory.

We also think that because it's within our aftermarket segment for the more routine type aftermarket orders, those transitory or temporary decisions – and you've heard us say this before, Paul –

are discretionary, and they can be done in short intervals. However, they're not long-lasting. So we do expect to see, as we move into fiscal 2018, a more normalized level of our short cycle work.

At this point, we haven't begun to see that yet, but that's our thesis for the near-term. And the slowing came relatively quickly in our second quarter. We can't really define what caused it. However, we're not seeing it abate as we go into this current quarter. So, therefore, our gross margin projection did come down a bit as a consequence of how we're viewing the short cycle work converting into sales during the third and fourth quarters.

Paul Dircks: That's helpful color, Jim. When the market does recover, is it your early expectation that there could be some incremental pressure on those aftermarket margins once those orders and sales are recorded?

James R. Lines: The industry, as a whole, is intensively focused on cost. We're not anticipating a materially different margin profile from that segment of our business as we move into fiscal 2018. We have seen some compression on the booked margins and the realized margins. Some of that is due to mix. We are seeing a focus on cost and cost pressure. But having said all that, we do expect to fall within our normal band of aftermarket margin.

Paul Dircks: Okay. That's helpful. Maybe taking a bit of a step-back and certainly appreciating the gross margin pressure from the aftermarket and short cycle businesses. Looking forward, how should we think about your outlook for utilization, given the fact that you were able to sequentially grow backlog in the quarter? And then, are there a number of other prospects ahead to further grow that backlog in upcoming quarters as you guys continue to execute on your diversification strategy?

James R. Lines: What's important to bear in mind is that we have gotten up in front of this in our prior commentary, we've been in the market being aggressive to hold share, take share and take strategic orders. And some of those larger project orders have had some challenging margins. But that was the nature of the work that was available at the time. We're happy that we took it.

So, while we will see improved utilization as our production hours begin to increase, we are going to deal with some margin headwinds from the types of orders that we took on to leverage our asset base and make sure our team had work to do. But I do want to comment that, while utilization will inch up, we're not necessarily going to have the same leverage in operating profit because of the margins we took some of this work at.

Paul Dircks: That's helpful. Last question for me. Obviously, this quarter we saw another leg down in the legacy market backlog. And as you think about that and you're planning towards fiscal year 2018, does that backlog level and the continued weakness we've seen in the short cycle business lead you to consider additional restructuring actions as we head into fiscal 2018? Or do you feel as if the business is appropriately sized for this energy market downturn that we're currently enduring?

James R. Lines: We aren't anticipating having to adjust costs lower, reflecting our view where perhaps we have begun bouncing on the bottom in terms of our traditional markets of refining and chemical/petrochemical. We have to bear in mind the long-term, and the management team will be prepared to think more long-term than managing a couple of quarters, if we do have a couple of rough quarters coming ahead.

I'm not projecting that we will, our attitude is that we're looking at this long term, and we'll take the actions that we need to manage the next couple of quarters. However, I'm not expecting that to come at the expense of, and will resist that urge to affect, our long-term growth potential. And that's paramount in the mind of our management team to be ready to capitalize on the upturn and to conceive some profitability at the trough to move more quickly into an expansion cycle.

Paul Dircks: Understood. Thank you, guys.

James R. Lines: You're welcome. Thanks, Paul.

Operator: Our next question is from Joe Mondillo from Sidoti & Company. Please go ahead.

Joe Mondillo: Hi, guys. Good morning.

Jeffrey Glajch: Good morning, Joe.

Jim Lines: Good morning, Joe.

Joe Mondillo: I was wondering about the $6.9 million of orders that you mentioned that were halted within the oil refining business; was that included in the quarter-end backlog? And also, are you assuming that this will be shipped out this fiscal year. Is that included in your guidance?

James R. Lines: That order it is in our backlog, we don't have a defined delivery date for those three orders, and they're not reflected in our 2017 guidance for revenue.

Jeffrey Glajch: Joe, just to clarify, there is no change in those three orders. So they were on hold in the previous quarter.

Joe Mondillo: Okay. Thanks. What is your feeling on that? Is that just a wait-and-see, and eventually, if things continue to stabilize and improve they'll come back? Or do you think there is a risk of losing those orders?

James R. Lines: I won't provide too much specifics, but we do have a couple of orders. Two of the three orders are on hold for our own management's reasons. We see credit risk in the countries that we're transacting this work in and, therefore, we want to have some cash flow coming in before we make commitments to advance the order. That's how we've managed the contracts in these regions before.

So, therefore, we've placed them on hold and we won't advance the orders until we receive some payments. At this point, we're not anticipating payments to come in a timely way, and we won't advance those orders in backlog until we do receive upfront money to cover our risk as we execute that contract.

On the other order, I think they're still going through some engineering considerations and final financing for the project. We got those orders relatively early, and we're just in a wait mode for them to advance the order and tell us to proceed. This one's on stop because of our customer. We have no identification of when that stop will be lifted. We don't expect it to have any effect, as I said earlier, Joe, on fiscal 2017 revenue. And at this point, we are actually being conservative, as we haven't modeled it in our internal management projections for 2018.

Jeffrey Glajch: Joe, the last order that Jim mentioned is the majority of what's on hold from a dollar perspective. The other two orders combined are smaller than the one that's on customer hold.

Joe Mondillo: Okay. With the backlog of refining falling sequentially, it looks like you have about $10 million of backlog within refining. The petrochemical backlog came up a little bit sequentially. I imagine that the oil and the U.S. Navy sequential increase won't hit this year. So with sort of net-net refining, and chemical sort of net-neutral, Navy probably is not going to hit this year. Please, correct me if I'm wrong. What was the thinking behind bringing up the revenue guidance on the low end?

James R. Lines: Let's clarify one thing. It was an action that we took in anticipation of orders that we would receive, to get in a position to execute them quickly, should we receive them. And we did receive a significant order from one of our key markets, and we do feel we'll be in a position to move quickly and get some revenue recognition on that. But that was because we spent six months in advance getting ready. So the day we got the order, we could move on it.

Joe Mondillo: Okay.

James R. Lines: It's out of the ordinary for us to be in that position, but we took that step because we felt strongly confident that we would be successful. And we wanted to be in a position to move rapidly once we got the commitment. The upward tightening of the revenue guidance reflects those actions by management a couple of quarters ago, to be in a position to move quickly.

Joe Mondillo: Okay. In terms of the insurance proceeds that you received in the quarter, what was that related to exactly?

Jeffrey Glajch: Joe, as you are aware, we have ongoing legal expenses related to decades of old asbestos exposure. We get involved in these suits, we'll go through them and ultimately we will be dismissed from those suits, however there are legal expenses that are incurred. We had identified an insurance carrier who we had coverage with many years ago and identified that they were going through liquidation. And so, we proactively were able to reach an agreement with them for a payment stream.

And while that payment stream would've been over multiple years, given their precarious financial situation, we decided to monetize that and take that in the quarter this year and receive that cash, which we have received. Those are expenses that are ongoing over multiple years and we felt that it was important to disclose that we had received these proceeds. They cover some expenses that we incurred in the past, and some current expenses that we see in the current year.

Joe Mondillo: Okay. Last question, and I'll hop back in queue. You guys used to have– I am sure you still do – a unique way for measuring quoting activity within bidding. I think it got up to as high as $1 billion at some point a couple of years ago. Just wondering what that graph looks like? Are we still declining on an activity basis? Do you see things stabilizing, or what are you seeing there?

James R. Lines: That is a graph that we have on our management dashboard. It's trending between $600 million and $800 million, which is consistent with what we had mentioned on the call one quarter ago. So, it's within that band. We think that it will hang in that area. We're not expecting further erosion from the $800 million to $1 billion down, to $600 million to $800 million. We're expecting to remain in that range as we go forward.

Joe Mondillo: Okay. Does that sort of give you indication that maybe things are stabilizing?

James R. Lines: Again, we look at those quotation pipelines as one of our lead measures and we look at that very carefully. We don't yet project that it's necessarily bottomed and bounced off the bottom. However, we do expect it to stay within the band that I just mentioned. What's also important to bear in mind is, while it still is a strong proposal book of business, conversion to orders is very slow; it's at a historic low.

So while we have that enormity of opportunities, $600 million to $800 million, the conversion to a booking is actually at a historic low level. Not a surprise for where we are in this cycle. However, what we'd like to see is that the inflection point is beginning to grow. And then we know 12 months, 18 months out, we're going to be coming out of this and back into an expansion phase. So we'll watch this very carefully. It's on our management dashboard and we talk about it all the time.

Joe Mondillo: Okay. Great. Thanks a lot. Appreciate it.

James R. Lines: You're welcome, Joe.

Operator: Our next question is from John Koller from Oppenheimer. Please go ahead.

John Koller: Good morning, Jeff, Jim. How are you guys doing this morning?

Jeffrey Glajch: Good morning, John. How are you doing?

James R. Lines: Doing great, John.

John Koller: Good, thanks. A couple of my questions have been answered, so I'll start with acquisitions. You are still hunting, I presume. I'm wondering, given the prolonged state of weakness with which we've been dealing in industrial manufacturing, if you're seeing spreads get a little more reasonable?

Jeffrey Glajch: John, the pricing is coming down a little bit, probably not as quickly as we certainly would like. We are still, as you noted, very actively looking. But it's obviously really a matter of finding that one company that's the right fit for Graham. We are being very active in our process and our hiring of a business development director back in May has really helped us broaden our net.

John Koller: I guess, I'll leave it at that, and I won't pursue that further. If I look at the refining business, in general, it seems like there is a fair amount of assets that are up for sale or are recently sold. Am I being too biased to assume that there is some correlation between that and possibly your short-cycle business?

James R. Lines: We have not made that correlation, but it's a plausible one. One thing that we have seen historically when an integrated company divests of its refining assets and then an owner-operator takes them over is that, once they take control of that asset, there is a step-up in investment, as they look to leverage those assets differently than an integrated refiner would, that's perhaps more focused on the E&P side of their business.

So we have seen in the past when that occurs, that it's favorable because they're focused on leveraging their infrastructure and getting more out of each barrel of oil, and that tends to be very helpful with demand for our products.

John Koller: Okay. Great. Those were my only questions.

Jeffrey Glajch: Well, thank you, John.

Operator: Our next question comes from Brian Rafn from Morgan Dempsey Capital Management. Please go ahead.

Brian Rafn: Good morning, Jim. Good morning, Jeff.

Jeffrey Glajch: Good morning, Brian.

James R. Lines: Hi, Brian.

Brian Rafn: Talking about capacity utilization, how many shifts are you guys running labor-wise at Batavia and Lapeer?

James R. Lines: For our Batavia operation, we're fairly consistent with our normal practice, running two shifts, although the second shift isn't as staffed as the first shift. And for Energy Steel, the Lapeer operation, because of our backlog conversion and where their business is, they've been running two strong shifts.

Brian Rafn: What is your capacity utilization?

James R. Lines: Of our physical plant?

Brian Rafn: Yes.

James R. Lines: I'd say we're probably running at about 50% of what our roof-line can handle.

Brian Rafn: Yes, okay. That's good. As you guys are planning for the next stage of $200 million in sales, you certainly don't want to lose technical capacity. Are there any long-term plans that you can do to avoid losing this capacity? I'm thinking extended vacations, unpaid leave, 30-hour work week, salary reduction. What are the types of things you can do to maintain your labor force without doing head count reductions?

James R. Lines: Those types of measures are certainly available to management. We have to look at that at a point in time when it would be relevant to consider such actions. Our management team takes a balanced approach of making ensure we have retention. We have an engaged workforce and they're in it with us through the bottom of the cycle and they're on our team coming out of the cycle. So we need to manage their engagement and their affiliation with our strategies and with management. We tend to be very careful on such actions and we will in the future. Although, I'm not saying those aren't unavailable to us.

Brian Rafn: Yes, right. Well, you've certainly got a great culture. The U.S. Navy just announced for the Columbia fleet Ballistic Missile Sub, some advanced procurement between 2017 and 2020. I missed it, you guys mentioned something about a large order. I must not have grabbed the press release. Are you seeing anything on the new Columbia fleet Ballistic Missile Sub, any work there?

James R. Lines: We did pick up some Navy work in this past quarter. We're not in a position to disclose that in any detail other than we can say, we've indicated we want to participate in the submarine and carrier programs with a certain product set and it's within that strategy. It's nothing out of the ordinary for us.

Brian Rafn: Okay. Looking at the Congressional Research Service, the Navy has come out under their 30-year shipbuilding. I'm just wondering if they are looking to deliver one Columbia hull per year between 2026 to 2035. Obviously, that's fairly far out. But that would be multiple hulls being manufactured probably in the early 2020s. Did you guys see any demand as you guys look to the Navy, as you're certainly a prime supplier? Is there a possibility that there may be some fairly significant expansion or is it probably a little too far out?

James R. Lines: With the investment we made to expand our roofline and prepare for potential naval work, we think we've made the infrastructure investments that are necessary, less a few more modern machine tools that we might need to bring in for what our appetite should be over the next 5 years to 10 years. Now, if we're presented with an opportunity to take on more work, and importantly, we feel we are in a position to execute that work successfully, we'll deploy more capital to take on those opportunities.

But as we looked at our sphere of opportunities and where we were focused, we've built the infrastructure and the organization to accommodate that additional work. We would have to talk about and understand if we need additional roofline and facility expansion to accommodate further types of work.

Brian Rafn: Right, right. The visibility is way out, so I appreciate the color there. Looking at condenser work for the Navy with the carriers, a lot of defense primes and subcontractors complain about the Military constantly doing change orders on specifications and requirements. In your work for the Navy, is that engineered in, like a fixed engineering design or are they constantly vacillating on specification and functionality changes?

James R. Lines: The engineering churn, or the way in which an order flows through to our business, is not very dissimilar from the orders that we get from the refining and petrochemical market. That's why we felt we had an appropriate operating model and execution strategy for the naval work. For us it's normal fare. We deal with it all the time. You might hear us lament about it, but that's our operating model. That's what we do extraordinarily well.

What we hear from a complimentary point of view, because we're very adept at this in our commercial work, is that we're a supplier to the naval program that's very proficient at this. We don't make every change an issue. And we have a fluidity and an adeptness to get back on track. They see us as a supplier that's different from their ordinary suppliers, largely focused on naval work. It's a part of our business, but it's not all of our business.

So we have skill sets and sensibilities, from what we're hearing, that deliver different performance than the typical supply chain that just serves the U.S. Navy, and that's a great compliment that our team has earned. I am glad to hear that our customer, in this context the shipyards, has identified this as a unique characteristic of Graham that's different from their ordinary supply chain.

Brian Rafn: Yeah. It's good, great. That's awesome. Appreciate the answer. When you guys look at, certainly you have an aptitude on the M&A front. I believe, Jeff you said that you're seeing a little bit of multiple compression. What would you say the number of deals available are, and are you seeing more distressed credits? Are you looking primarily for more higher-quality going concerns or turnarounds?

James R. Lines: Brian, that's a good question. We are actually seeing more that are distressed situations, or companies that are clearly heading in a very bad direction. Those generally do not interest us. Typically, in those situations, they're selling assets more than anything else and that's not something that's particularly interesting to us. I mean, obviously, if there was a particular asset that we found appealing, we would look at it. But we're really looking for operating businesses that are profitable. So while we're hearing more of those recently, it's really not an avenue that we're pursuing particularly hard.

Operator: Thank you. Our next question comes from John Bair from Ascend Wealth Advisors. Please go ahead.

John Bair: I am little late on this call, I am calling from Cleveland. So I'll start off by saying Go Tribe tonight, to the distress of those in the Midwest. Regardless of how the series plays out, one of these team is going to end their drought. And I think that's certainly a good way of looking at how this long stretched-out, distressed market has been for the energy sector.

So, anyways, trying to lighten things up here a little for you this morning. If you had to pick one thing that you're most optimistic about, whether it's in the near-term or perhaps over the next 12 months to 24 months, what would that be as far as your business goes?

James R. Lines: I only get one?

John Bair: Well, if you have multiple that would be even better. I mean, you're in a cash position and it seems like oil prices are stabilizing out. So hopefully we're at a trough. Right?

James R. Lines: Right. So, let me, just at a high level, walk through what maintains our optimism and our positivity around the long-term thinking. One is the stage of our backlog conversion for the naval work. You've heard Jeff and I talk about, as we're going into 2018 and 2019, we begin to convert that large backlog into revenue. So that is set-up. That's being executed well. And we believe that will be realized. So therefore we'll have the lift that we had been indicating to everyone that was coming, materializing, when we said it would come across fiscal 2018, into 2019 and into 2020. So that's very strong and encouraging and gives us great positivity.

And these points are in no particular order. While Jeff intimated very well, there still is a gap between seller value and prospective buyer value, at least in the deals that we've been chasing. And we have had some that we just couldn't close that gap. They were a couple of turns apart, and we're not prepared to step-up to that. But what I'm happy about is that we brought in our business development director to work with Jeff, our pipeline of opportunities and our dialogue there is much more frequent. So, I'm very pleased about the focus we have there. I can't advise whether we'll close the valuation gap or not, but I'm very pleased with the opportunities and the number of conversations that we are having. And that we actually got pretty far along on a couple of opportunities where we just couldn't close the gap, which was, while unfortunate, it was fortunate that we were able to get to the table and have those definitive conversations.

And then on the refining/chemical side, this is a tough downturn. You've heard me say that, because I'm the gray-haired one in the room here, that this is a tough downturn, more difficult than the previous downturns, more difficult than the downturn going back to the early 1980s. And indeed, we feel a lot different today. However, our actions that we're taking, we're getting closer to our customers, we're trying to spend more time with the opportunities that are developing and emerging, and doing so earlier. So we're redeploying our sales force into the plants.

We had an EPC centric sales focus, and while we still have a very important focus on the EPCs, we're moving our resources into the plants, into the end-user, because that's where we feel aftermarket will turn quickly. Revamps and debottlenecking will be where the investments will come first into the recovery. And then we plan to be the ones that are there early, engaging those opportunities and be the one to capitalize on those. The time to do those things is when no one's spending money. We're jumping into those situations while they're not spending money, and we feel that we'll benefit from that when this does recover. Eventually, we will be bouncing out of this.

On another optimistic note, we're not a victim here. These are the markets we've chosen to play in and we're taking the right actions. We have the right attitude. We have the right long-term perspective in the entire organization to get through this downturn. And what's most important on the backside of downturn is, we've done something to change our growth trajectory. And I'm really pleased across the fronts that we're acting upon that, and we will be in a position to be able to do that.

John Bair: Okay. Well, that's good. I can just say hang in there and keep swinging away. You've long stressed that you've won orders based on reputation as opposed to pricing on the bids and so forth. I'm wondering if that is still the case or whether, in this rather slow type of market, there is much more pressure on pushing your bid cost down, which I would assume is being reflected in your lower overall margins. Is that a fair statement?

James R. Lines: It's a very accurate statement. It's bottom of the cycle fundamentals. We saw it in the late 1990s. We saw it again in the late 2000s. We're seeing it again today where there is a greater fixation on first cost than lifecycle costs. We have many discussions with our sales folks that are addressing these more price-focused decisions of where do we want to play, when do we want to play, when do we want to react in that manner because, at times, you can irreparably harm the market price. And these have been transitory type actions by our customer base in our past, that haven't been enduring.

So it really tests one's model. We believe we lead with value. We believe we lead with technical superiority. We expect to be paid for that. I expect our sales guys to derive differentiation and sell at a premium. However, in the bottom of the cycle, that does test our model. And our sales folks are doing a great job to get us in a position to have the right intel and ensure we make the right decisions. You've heard me say a couple of times on prior calls and again this call, we will take orders aggressively and secure strategic orders to hold market share, or to keep a competitor out of an area we don't want them in. And we do that judiciously.

We try not to harm our value proposition and convey to the market that we are a price leader because that's not who we are. We lead with value. We lead with expertise. And these decisions are tough. We went through them in the late 1990s, we went through it again in the late 2000s, and our value proposition, John, I think is still sound, still is enduring. But it does test your model the longer this goes on. And I have a pretty strong fortitude in this regard of who we are, what I expect from the marketplace, what I expect from our sales folks, and I don't vacillate too often.

John Bair: Great. Well, very good. Having a rock solid balance sheet certainly helps weather the storm. So, good luck and, again, Go Tribe. Bye.

James R. Lines: Thanks.

Operator: Our next question comes from Paul Dircks from William Blair. Please go ahead.

Paul Dircks: Hey, guys. It's Paul again. Just a couple of quick follow-ups, if I may. Jim, you had mentioned earlier that one of the actions you took was to get ready strategically in case an order came in, so that you'd be able to ramp on that work quickly in the event that it did. Now that it has came in, does this action have ramifications for Graham, so that you could win yet more work from this key customer or in this market sector? Or was this a discrete one-off opportunity, with no real follow-on opportunities, that could follow from your strategic actions ahead of time?

James R. Lines: The case that I cited was more specific to a one-off. However, what we do with some regularity is that when we're feeling our positioning on an opportunity is relatively strong and the design to the best of our knowledge is frozen, we will move in advance of an order to get into the engineering and start our work. So, when we do receive the order, we're able to convert that more quickly. That's our normal process. We do that more regularly than we've conveyed before. But that's, again, more situational.

We look at each of those situations. Are we in a position to win? Is this just timing? Do we have the engineering capacity? Yes/no, let's get in front of it. It's there a critical deliverable that we have to have, whether it's the engineering deliverable or the hardware deliverable? Let's give ourselves the opportunity to be successful by moving in advance. So we do take on that risk. And then, in the course of a year we probably do it a half of dozen times a year to a dozen times. The situation, the opportunity that I cited, was more specific. So, I don't want you to think there is more for that one to come, but we do take those actions with some frequency.

Paul Dircks: Okay. That's helpful color. You had also mentioned earlier about the reduction in planned capital expenditures for fiscal 2017. Was that specific to some of your preparedness for Navy work or was it related to the growth investments that, simply because of the energy market downturn, you could defer to next year or the year after?

James R. Lines: With complete candor, part of it was our bandwidth in capacity to deal with what we are doing on the execution front, and then also execute some capital plans. I have spoken with our operating managers and said I want renewed focus on deploying capital to bring our cost basis down or to create opportunity to take on more work. I recognize we could do this or that. We focused on revenues and order conversion, and we had less commitment toward our capital plans. So you've seen the result of that.

But I have met with the team and said I want some actions taken here during this downturn. So we are coming out of this operating differently with a lower cost basis and with higher productivity. So that's what happens when you're in a downturn and you're not struggling, you're dealing with the order execution and sometimes you have to make that trade off. I would call it a time-based trade-off.

Paul Dircks: Understood and completely rationale. Last question from me. On the power market, and this hasn't really been a major focus of this call thus far, it was good to see the shipments in the quarter, but the orders in power over the first two quarters of fiscal 2017 have been low. What's your expectation near-term in that business? Obviously, you've been investing in personnel over the last year or two to improve your customer facing opportunities. And maybe you could also tie that into what your current view is of the nuclear power aftermarket and some of the new build nuclear opportunities that you're pursuing in the U.S. and China as well?

James R. Lines: Well, no doubt about it, Paul. We need to turn the backlog direction upward. And for the first two quarters, order levels were light. We had the benefit of a stronger backlog going into this year. Our team is in the field. Our team is creating opportunities. We have a rich pipeline of opportunities. We are seeing some slowness there in converting that pipeline to bookings. And also we're seeing a stronger prioritization on price, which is new for the nuclear market. And that has affected our success rate, or the margin on some of that work that was placed.

The nuclear utility market is looking to lower its capital costs and operating costs, and they're pushing that into the supply chain. So, that is having an effect, to a degree, on where we want to play and what our capture rate has been. But, in the end, summary comment, we've got to grow backlog. We've got to continue to expand that strategy. We have the right team in place led by a nuclear market veteran, and he's done a great job in building the infrastructure for his team to be successful, and our intent is turning that around and expanding that backlog and, therefore, expanding our revenues. But you are accurate, the first two quarters have had light order intake.

Paul Dircks: Is there anything in the near-term horizon regarding the new build nuclear opportunities, U.S. or in China?

James R. Lines: There are 12 new reactors up for procurement in China, round numbers. Two-thirds of those are Westinghouse AP1000; one-third are CAP1400 Westinghouse, copycat by the Chinese. We are following those opportunities. We expect those to close over the next 18 months. And we are hopeful because we got the four reactors at Sanmen and Haiyang. We were participating in those projects through our China office. So, therefore, we are focused on winning some of that work.

And then for Summer and Vogtle, the two new U.S. builds, there is work we're pursuing there, in addition to the work we're wrapping up and some of it's fairly sizable. We have some meetings coming up where we'll be meeting the key decision makers there to try to secure some more work for the Summer and Vogtle projects. That whole supply chain has really been strained in trying to bring those projects to conclusion. And we think we have the right formula, the right execution capability, the right focus on risk management. And we're going to convey that to them that we're ready, we want this work, and we can deliver it. Our job is to convince them that we can do just that. So, there is more opportunity there.

Paul Dircks: That's good to hear. Thank you, guys.

James R. Lines: Thank you, Paul.

Operator: I'm showing no further questions at this time. So I will turn it back to management for closing remarks.

James R. Lines: Well, thank you, everyone, for your questions. We had a good call. We discussed a number of the near-term and longer-term implications of the markets on our business. Jeff and I, we look forward to updating you on our next call in about three months. Thank you.

Operator: This concludes today's teleconference. Thank you for your participation. You may disconnect your lines at this time.