Operator: Greetings and welcome to the Graham Corporation Fourth Quarter Fiscal Year 2014 Financial Results. At this time all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

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

Karen Howard: Thank you, Melissa, and good morning, everyone. We appreciate your participation in our fourth quarter fiscal 2014 financial results conference call. You should have a copy of the news detailing Graham's results that was released earlier this morning. We also have slides associated with the commentary that we're providing here today. If you do not 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, we have 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. Then we will open up 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 here today.

These risks and uncertainties and other factors are provided in the earnings release and the slide deck as well as with other documents filed by the company with the Securities and Exchange Commission. You can find these documents on our website or at www.sec.gov.

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

James Lines: Thank you, Karen. Good morning, everyone. I will begin on slide three. I'd like to restate that our strategy for this current cycle is to grow our business to exceed $200 million in revenue. We will remain committed to providing engineered-to-order custom fabricated products to principally the energy and related markets. This is where our brand is exceptionally strong and where we're rewarded for the differentiation that we have in our selling process, engineering know-how and capabilities, our low-volume high-mix operations model, and for our overall service to customers and aftermarket support.

Please move to slide four. Orders in the fourth quarter were $23.5 million and full year orders were a record $128 million, up 34% from the prior year. Year-end backlog was $112 million. Fourth quarter revenue was $26.1 million, up 6% to 10% from the previous two sequential quarters. Full year revenue was $102.2 million. We earned $2.3 million or $0.23 per share in the fourth quarter and $10.1 million or $1.00 per share for the full year. We added $9.4 million to balance sheet cash and investments during the year. Top line growth for fiscal 2015 is expected to be between 17% and 27%. This is based on order expectations and strength of our March 31 backlog.

I'm referring now to slide five. During the fourth quarter, we began to have the impact of the North American chemical industry orders that were won during the June to September timeframe last year. Chemical industry sales were $10.5 million in the quarter. There was a good balance of sales among our other key markets.

On prior conference calls, it was mentioned that it was to be anticipated, there would be engineering churn between us and our customers that would affect finalizing designs and getting these North American chemical industry orders into production. This was because certain orders were won early in the procurement cycle of our customer, and therefore, would have design conditions not finalized until after the order. We had hoped to begin production sooner, such as during the third quarter, however, many of the orders are now released into production, as can be seen by the level of chemical industry sales during the quarter. Seventy-eight percent of sales in the quarter were for U.S. installations, and for the year, it was 62% of sales.

With those brief remarks, let me turn it over to Jeff to provide financial details. Jeff?

Jeffrey Glajch: Thank you, Jim, and good morning, everyone. I am on slide seven right now. Q4 sales were $26.1 million, down from $30.9 million in last year's fourth quarter, but up from $23.4 million from the sequential quarter in fiscal 2014. As Jim mentioned, the sales split in the quarter was 78% domestic, 22% international. That compares to last year's fourth quarter which was 53% domestic and 47% international. Gross margins in the quarter were 28.4%, down from 34.1% last year, but up sequentially from 26.0% in the sequential quarter.

EBITDA margins were 14% in Q4, down from 20% last year, but up from 11% in Q3 of this year. Q4 net income was $2.3 million or $0.23 per share compared with $4.1 million or $0.41 per share, but again sequentially up from $1.4 million in last quarter.

Turning to slide eight, full-year results were relatively flat compared with last year. Sales were $102.2 million, down just under 3% from $104.9 million last year. For the year, domestic sales were 62% and international sales were 38%. This compares with last year when domestic sales were 53% and international sales were 47%.

Gross profit was flat at $31.8 million, though gross margin increased to 31.1% from 30.3%. SG&A for the year was $17.3 million compared with $16.6 million last year. However, last year we had a $975,000 one-time credit related to an earn-out adjustment. Adjusting that out, SG&A was actually down by $340,000.

EBITDA margins were flat at 16.5% and net income was down $0.11. However, when adjusting out last year's one-time credit, EBITDA margins were up 90 basis points and net income was essentially flat, down just $28,000.

Turning to slide nine, our cash position, as Jim mentioned, increased by $9.4 million up to $61.1 million at year-end. While our capital expansion in Batavia is fully on track to be completed this summer as planned, the cash outflow has been a little slower than planned. We have spent approximately half of the cash for the project. Our full year capital spending was $5.3 million. Therefore, as we look at fiscal 2015, we expect to spend $5.5 million to $6 million, of which approximately 60% will be to complete the capital expansion here in Batavia.

We expect to continue to generate strong operating cash flow in fiscal 2015. Much of the cash early in the year that is generated will be used for the capital expansion, but we expect full year cash flow still to be very strong. We continue to have a clean balance sheet with no bank debt. This allows us to focus on utilizing this cash and, if necessary, our untapped line of credit for not only internal growth and investment opportunities, but also for future acquisitions.

With that, Jim will complete the presentation and comment on our view for fiscal year 2015.

James Lines: Thank you, Jeff. I'm commenting on slide 11. I'm very pleased with full year orders of $128 million. In the third and fourth quarters, we observed some hesitancy, but more what we believe to have been staging by our customers for the next wave of orders that are expected to break in fiscal 2015.

For the fourth quarter, there was even balance of orders by market segment, again, our U.S. markets were strong, contributing 63% of orders in the quarter. By comparison, orders for domestic end users were 72% of total full year orders. Our bid pipeline is still strong, double the size it was in the fiscal 2004 timeframe. In the pipeline of bids is a considerable level of North American chemical industry activity along with a strong amount of global refining market bids.

Moving on to slide 12, backlog is up 30% from a year earlier. I'm pleased with the balance in our backlog across our key markets. Roughly 40% of the $112 million of backlog is from markets or customers that are new since fiscal 2009. That is exciting to see, and proof that our strategies to diversify have had a positive impact on our business. Seventy to seventy-five percent of backlog is projected to convert in fiscal 2015.

On to slide 13. Fiscal 2015 is set up very well. There is a terrific level of backlog entering the year, with approximately $80 million of the backlog projected to convert in the year. Market fundamentals remain strong, our bid pipeline is elevated, margins do appear to be inching higher and, importantly, we are a business today that can execute much differently than in our past. The year is expected to build as we move quarter-to-quarter, where Q1 is a step-up from the past quarter and Q2 is projected to be stronger than Q1.

Full year guidance is for revenue to be between $120 million to $130 million with gross margin at 30% to 32%, SG&A of 15% to 16% of sales, and a tax rate between 33% and 34%.

Melissa, I would like the call opened for questions at this time.

Operator: Thank you. [Operator Instructions]. Our first question comes from the line of Chase Jacobson with William Blair. Please proceed with your question.

Chase Jacobson: Hi. Good morning.

Jim Lines: Hi, Chase.

Jeff Glajch: Good morning, Chase.

Chase Jacobson: I have a question about the revenue guidance first. You guys had good awards this year, but looking at your backlog and the expected 70% to 75% that's going to convert to revenue, it assumes a pretty meaningful piece of the revenue in fiscal 2015 comes from new awards. Am I right to think that there should be a meaningful pickup in orders in the first half of fiscal 2015?

Jim Lines: That's a fair way to think about it, yes.

Chase Jacobson: Related to that, for a lot of the E&C companies, projects come out with schedules, then the schedules tend to move to the right, and it's not always fundamental – it's really just the way the market works. What gives you the confidence that these prospects convert to firm orders with firm schedules in the next three to six months?

Jim Lines: Sure. Chase, I would expect your comments relate primarily to the North American chemical/petrochemical situation where there is this continued movement to the right. We are seeing that. We have, as we announced this morning, secured an order for the North American chemical industry, a new ethylene plant. We do have confidence that others will be secured over the next couple of quarters. But importantly we're not just focused on the North American chemical markets. We do have in our pipeline some faster turn projects, in terms of the bid work. They convert more quickly, and there are refinery upgrades or revamps for the North American market that we are expecting to close either this quarter or next quarter and we have line of sight to those projects now.

And all in all, as we look at the bid pipeline and the activity of our discussions with our customers, we have this confidence that if our backlog is at $112 million, 70% to 75% converts over the next 12 months, that's roughly $80 million, suggesting another $40 million to $50 million is needed to land within the guidance of $120 million to $130 million. I am not uneasy about that top line guidance.

Chase Jacobson: Okay. That's really helpful. Jeff, on the gross margin, I know you had some benefit in the first half of fiscal 2014 with the after-market stuff coming through, but when we look out, does the flattish gross margin year-over-year have more to do with the pricing at this point in the cycle? Or is it because that outsourced work is still flowing through the income statement? And is this the type of thing where once that outsourced work is shipped, we see a meaningful step up from the higher-20%s into the low-30%s? How does that progress during the year?

Jeff Glajch: As we think about the gross margin, and that's a good observation of 30% to 32%, what's important to bear in mind is where we are in this recovery. I would argue we're still early, we're entering the recovery that hasn't reached its full stride yet. And I would contrast where we are now to where we were in fiscal 2006 and 2007. If you contrast the 30% to 32% gross margin we're projecting here to fiscal 2006 and 2007, which was mid-to-upper 20%s, I would characterize both market fundamentals to be quite similar. As we move forward, we're expecting margins to continue to inch up. Again as I mentioned in my prepared remarks, we're beginning to see that occur with the quality of what's coming into our backlog. Thus, we have to deal with the margin quality of what we booked the last 12 months to15 months, which I don't believe is bad. It's more representative of where the market cycle was at that point in time. As we move forward, I'm expecting improvement in margins as we go through a few more quarters. And as we get into 2016, we would expect margins to continue to improve.

Chase Jacobson: Okay. And just one more question. Can you comment on the Navy opportunity, in terms of the shipbuilders and other suppliers, with some of the big submarine contracts announced recently? You've had good results in your other category, particularly on the awards side. Can you just comment where you stand with the Navy as it relates to carriers or submarines at this point?

Jeff Glajch: You're right, there have been a few announcements regarding funding appropriation for Virginia class and Ohio class programs. We are involved in those bidding activities. We do feel that this coming year, fiscal 2015, will be very important for us and that it will validate the strength of our strategy as we enter more fully into these programs. That's my expectation. This will be a very important year for us to demonstrate that the strategy has traction. The Navy is receptive to the value and the support we provide and we're looking forward to bringing these orders in.

Chase Jacobson: Okay. Thank you very much.

Jim Lines: Chase, just one follow-up on that, you may have noticed in our slide deck on slide 12 that we have broken out what used to be the "other" backlog into "defense" and "other". What you'll see in there is that of our total backlog, approximately 25% of it is defense, just as a reference point that's something we started breaking out now.

Chase Jacobson: I did see that. Thank you.

Jeff Glajch: Just to clarify further, the comments that I made relate to the submarine programs. We do expect to begin to see activity for CVN-80, the next carrier. Sometime during the next six to 12 months is when we would expect to see the bids come out for that.

Chase Jacobson: Okay.

Operator: Thank you. Our next question comes from the line of Jason Ursaner with CJS Securities. Please proceed with your question.

Jason Ursaner: Good morning.

Jim Lines: Good morning, Jason.

Jeff Glajch: Good morning.

Jason Ursaner: I appreciate the details you provided Chase on the revenue guidance and the confidence that you'll generate the order book from that bid pipeline.

Just a couple of follow-up questions…. Obviously, you narrowed the revenue range by $5 million on both ends. In terms of taking out the top end of the range, I just want to make sure I understand. It sounds like this is just the level of order activity you've won to date and the timing for how those shipments are going to shape up for the full year, but that you're not signaling any change in terms of the overall cycle opportunity and what you're seeing over the next couple of years? Is that the right way to be thinking about it?

Jim Lines: That is a correct way to think of it.

Jason Ursaner: Okay. Assuming the order activity does materialize as you are expecting, and revenue averages out to $30 million or above a quarter for the whole year, if I look back the last couple of times you've eclipsed that threshold, the average gross margin in the quarter was above 36%. Could you talk a little bit more about the pricing environment now, because it was my understanding it really hasn't been too different than the last couple of years, and if anything maybe has gotten a little better. Can you explain why gross margin wouldn't be more consistent with some of the higher levels you've generated in the past?

Jim Lines: There were two times when we popped over $30 million. In the most recent case, and we had commented on this, it was due to the strong level of short-cycle quick-turn aftermarket type of orders that were for the U.S. refining market, they came in and came out relatively quickly. We didn't anticipate, and we were accurate, that it would have been sustained, so that was a unique case that I think goes back to Q1.

Then a year or so earlier, we had a very strong quarter that reflected the margin of an international refining project that was actually won at the peak of the last cycle in terms of the pricing power, but was put on hold for production until fiscal 2013. We benefitted from that pricing environment and revenue conversion three or four years after the pricing was established, which was the peak of the last cycle. That was not representative of the market environment at that time.

What you're seeing here with the 30%-ish gross margin, 30% to 32% gross margin, is very similar to the gross margin we wrapped up this past fiscal year. That, truly, is indicative of the market environment we're in right now as we look back for the last 12 months, and therefore lead through to sales. But the point I want to make is, I would compare the market environment now and last year to what it was like in fiscal 2006 and fiscal 2007.

Jason Ursaner: Okay.

Jim Lines: We are not into strength of the market yet.

Jason Ursaner: Just staying with that, in terms of the core pricing environment, I think you characterized it as still representing more of an early cycle. How much room in just core pricing is there relative to where you had previously been in some of the top cycles? Is there still a lot of margin room left relative to where you are writing these, excluding the short-order work and all that stuff?

Jim Lines: I firmly believe so, and as Jeff and I have said over the last couple of years, during the white-hot periods of the last cycle, fiscal 2008, fiscal 2009, we eclipsed 40% gross margin. We expect this cycle not to be quite as strong, but to push gross margins to the mid-to-upper 30%s. With that as the basis, I would expect there to be measurable margin improvement as we go into this cycle.

Jason Ursaner: Okay. I think you had mentioned 25% of the backlog is defense. Is the expectation for military contribution as a percent of revenue pretty similar to that? Or is a lot of that backlog multi-year?

Jim Lines: That backlog Jason, is more extended. We envision over 2015 and 2016 that our defense strategy will represent somewhere below 10% of revenue. However, as we go forward, looking beyond the next two years, and we intend to actualize our strategy here, we would expect to see the Naval program, the defense program, represent 15% to maybe 20% at the upper side of our revenue.

Jason Ursaner: Okay. Last question for me, I know the cash balance is down a little bit from last quarter, just because of the investment you guys are doing. But overall, I think you guys have done a really great job there. Even with the higher CapEx budget for next year, obviously there's still a lot of cash and excess liquidity on the balance sheet. Could you walk through any additional details on the acquisition environment you're seeing? Are price expectations from sellers pretty reasonable right now? Are there any specific adjacencies that you can talk about that are more interesting or less interesting than others?

Jim Lines: Jason, while in some areas it's still pretty pricey, there are other areas of the acquisition environment right now that are more reasonable and, obviously, we would look in the latter category. We have a pretty consistent pipeline at any point in time of opportunities, and for us it comes down to finding that right company. We have a pretty wide net out there of places that we would look, whether it's in adjacent markets or it's in areas that would leverage our sales team. We're continuing to look and, again, it's just finding that right company. But in terms of the pricing itself, there are pockets of the market that are pretty reasonable. It does seem to be picking up a little bit.

Jason Ursaner: Okay. Great. Appreciate all the commentary. Thanks, guys.

Jim Lines: Thanks.

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

Joe Mondillo: Hi, guys. How're you doing?

Jim Lines: Good morning, Joe.

Jeff Glajch: Good morning Joe.

Joe Mondillo: My first question, and I know the last two callers asked about it, but I just want to touch on gross margin, if you will. It seems to me, utilization fell dramatically following the 2009 recession. We saw a bounce back in 2011/2012. Since then, really, revenue for you guys, at least, has been fairly flat on an annual basis.

I was wondering if you could comment, because my feeling of things is that capacity utilization amongst the industry was just so low through last year. We've now started to see orders come back and we are looking at mid-20% growth on the top line this year. If we see another strong year of orders this year, you're going to see another growth on top of that in 2016. My question is, by the time we get to 2016, because utilization amongst the industry as well as yourselves, are you anticipating at that point in time to see a pretty big uptick in gross margin after seeing at that point in time two years of strong top-line growth? Any comment on that would be good.

Jim Lines: We would anticipate if what plays out is what you described and what we believe, which is year-over-year strength as the markets progress through this recovery and expansion, that we would begin to garner some leverage and we also would begin to be favored with a step up in pricing power. You couple those two together and we begin to visualize that our gross margin moves into that mid to upper 30% range.

Joe Mondillo: What are your plans for head count this year?

Jim Lines: Our head count will likely go up by approximately 20 more people from, round numbers, 400 people. We've been adding about that number per year for the last couple of years.

Joe Mondillo: Okay. In terms of raw material prices, how are you gauging that in terms of your gross margin expectations?

Jim Lines: We are anticipating as the recovery goes on that input costs go up. Our process, though, is that we tend to pass that cost directly onto the customer base with the short validities that we have and our ability to lock down raw material cost after we have an order. We are expecting material cost to increase; however, we're not expecting it to erode our gross profit. We'll pass that onto the market as quickly as we can, and we stay on top of that very vigilantly. We watch that closely and so we are anticipating nickel decline, copper decline, and carbon and steel to increase, and we're already reflecting that in our bids ahead of those true cost increases.

Joe Mondillo: Okay. So if we see raw material prices start to decline throughout the year, that could probably be a benefit to the guidance that you have out there, given that you record the contract? And then any benefit and downside of prices, you'll benefit from that at the end of the shipment?

Jim Lines: Not really. There could be, of course, and I would expect our supply chain to grab that when they can. But our process is, for volatile materials, and I would say nickel-based, copper-based, and exotic alloy-based material, we don't gamble. We take the order and we commit as quickly as we can to lock in our costs. There might be some improvement in raw material cost with carbon, steel, or some other peripheral materials that we would buy that we could enjoy some improvement as costs drop down, but I would not expect that to measurably change the gross margin.

Joe Mondillo: Okay. Shifting gears to domestic versus international, what is your sense of things internationally? Do you anticipate any sort of improvement going forward here? What's your sense of that part of the world?

Jim Lines: I think we will continue to see a strong North American chemical industry marketplace. However, on the global front, we're seeing our bid activity for the refining sector improve. I would expect to see global refining work pick up as this year progresses, with international chemical/petrochemical in Asia begin to pick up. The Middle East is probably another year or so out.

Looking at 2015, I would expect, again, the focus to be on the strong market in the North American chemical industry, North American refining upgrades and revamps, and then ongoing improvement in the international refining markets.

Joe Mondillo: Are you seeing any signs of that? Bidding activity or anything internationally?

Jim Lines: We're seeing it in our bids.

Joe Mondillo: Okay. That's just recently turned, in the last quarter or two? I'm just basing it off of some of the weakness that you've seen in Asia and Middle East the last two quarters.

Jim Lines: Sure. We are seeing the bidding activity, some of it is early which doesn't suggest that there are orders closing for these opportunities in the next quarter, but there are bidding activities for some of the projects that had announcements that they are green-lighted to go. Examples would be the Kuwait Clean Fuels Projects, some additional work in Oman where Sohar refinery is, and then in Asia, Malaysia, the Petronas refinery activity, and we are seeing China begin to come out of its pullback with some refining works from both Sinopec and PetroChina along with CNOOC. We're really encouraged by all of this put together. It doesn't mean it's right in front of our windshield and it's going to close next quarter. But the fact that we're seeing the bids come into our pipeline, we're doing the early work, things that we do very well, it bodes well for coming quarters as we look out.

Joe Mondillo: Okay. Lastly, the 25% to 30% in the backlog that's beyond fiscal 2015, is all of that planned to be shipped in 2016 or is there anything further out?

Jeff Glajch: There is about 10% of it that's more than two years out. I think that's on slide 12 of our chart.

Joe Mondillo: Okay. Ten percent of the total?

Jeff Glajch: Correct.

Joe Mondillo: Okay. All right. Thanks a lot.

Jim Lines: You're welcome.

Operator: Thank you. Our next question comes from the line of Brian Rafn with Morgan Dempsey Capital Management. Please proceed with your question.

Brian Rafn: Good morning guys.

Jim Lines: Hi, Brian.

Jeff Glajch: Good morning, Brian.

Brian Rafn: How would you quantify your bid/quote activity? Would you say it's robust? Would you say it steady? You said that since 2009, 40% of the orders are from new customers or customers you didn't have previous to that. Does this new penetration of customers broaden at all your base business in the future for repeat business with newer customers? Does it give Graham a little bit of an advantage on award day?

Jim Lines: Okay. There are two questions there, the first one is the bidding activity is quite intense. Our sales guys are trying to come up for air, they are very busy, a lot of quote churn, just a tremendous amount of activity. I am pretty encouraged by that, that's a good leading indicator from how I judge it in my chair.

In terms of diversifying as we've done, the defense strategy and our focus in the power market along with broadening the customers that we access in our traditional markets of refining, petrochemical/chemical and related markets, we've thought about the importance of moving our fixed base higher, the predictable level of business that doesn't have the variability of our major contract work. Ultimately, we want to dampen earnings volatility. The way we envisioned doing that was by diversifying into new markets, the power and the defense markets, along with a strong focus on moving our predictable fixed base higher.

I'm extremely pleased by where we've been able to move our fixed base. I feel strongly that we will have a stronger performance this coming downturn, whenever that might be, than we had last downturn because of our diversification and our focus on the predictable base business.

Brian Rafn: Yes, okay. Okay. That's what I thought. Let me ask you, because your boots on the ground out in these markets is better than any of us on the call, what is your sense, Jim, of the propensity across some of your end markets to get some receptivity, some of that quick-turn short-cycle business as a kind of fill in?

Jim Lines: From a quantitative point of view it stepped up. We've seen that segment of our business, what I refer to as our predictable base, move up both in volume and inch up in margin. Again, I am quite pleased with that, and we are seeing that in our OEM sector, our work in the petrochemical sector, and some industrial sectors, along with our small work that we sell to refining petrochemical markets. Partly in there is aftermarket and that's been moving up as well. Across the broad-base market segments we serve, our strategy to drive our less cyclical portion of the business higher is executing very well thus far.

Brian Rafn: Okay. All right, good. You talked about how 60% of the \$5.5 million to \$6 million property, plant, and equipment CapEx budgeted will be to finish out the expansion. Can you give a little visibility relative to what it is, specifically, that you're going to spend in the next year? Is it more buildings? Is it equipment installation? Is it welding furnaces?

Jeff Glajch: If we look at the expansion that we've referenced in our remarks, that is two things. One, there is some additional roofline there. But on top of that, we are utilizing older roofline that had not been utilized in the past and putting some manufacturing equipment under that roofline. So, it's really both in that regard. The remaining capital spending that we have, the other roughly 40% or so, is just kind of normal ongoing maintenance capital as well as improvement in the manufacturing of our existing production line.

Brian Rafn: Yeah, okay. Jeff, on the additional machinery and tooling, is that incremental tooling that gives you competencies in new areas? Or are you just expanding the footprint of what you already have, whether it's welding or tooling?

Jeff Glajch: It's more of the latter, and it also gives us much more flexibility around our production process. One of the issues that we have is, if you've seen any of our equipment, it's just pretty darn large and it can sometimes block other production because you can't move it when it's partway through production. This gives us more flexibility and ability, as well as more floor space. At the end of the day this just gives us more capacity but it's very similar to what we do today from a production standpoint

Brian Rafn: Yeah, okay. That's what I'm looking for. Where is the cash invested, Jeff?

Jeff Glajch: Cash is invested primarily in money market accounts, and some is in treasury bills and CDs in the United States. About 5% of our cash or roughly $3 million is invested in our entity in China but that's the only cash that's offshore.

Brian Rafn: Okay, okay. Jim, you spoke a little about the Navy side. A couple of questions, the USS Gerald R. Ford, CVN-78 is still in, I don't know if you would call it preliminary sea trials, but there have been some problems with the EMALS, electromagnetic launch. It's brand-new. It's not the old steam catapults. Are there any issues that you are seeing that would cause the Navy from a design standpoint having a brand-new prototype carrier, CVN-21, that might slow down the John F. Kennedy or the Enterprise?

Jim Lines: The program is structured to be on five-year centers, each carrier comes out every five years. Is it conceivable, Brian that the centers for CVN-79 to CVN-80 move to a six year center? That's possible. I remarked earlier that we anticipate, sometime in the next six to 12 months, seeing the bidding activity begin for CVN-80, the next carrier. Bearing in mind we won that order for CVN-79 in December of 2009, a five-year center would suggest approximately the end of calendar 2014 will be when procurement occurs.

We would envision a little slide to the right, I don't know if it's pushing out fully to a six-year center or longer, but there is some push out. When you have a new class vessel coming out which is what CVN-78 was, they tend to take a bit longer with the launch of the first vessel as they work through the design. Some of that still gets worked out in CVN-79, the next vessel and it gets lined out as we move to CVN-80. We are still very optimistic and everything we're hearing suggests somewhere between a five and six year center between CVN-79 and CVN-80.

Brian Rafn: Yeah. Okay, I think that that dovetails with the shipbuilding plans. Do you have any sense from the standpoint of your business with the Navy you're looking at the Virginia-class attack sub business, maybe a replacement for the Ohio-class boomers. Is the carrier business for you, from a content standpoint or from an ease of bidding standpoint, any different than what you anticipate on the submarine side? Or is the Navy pretty much the same customer?

Jim Lines: None of it is easy but they each feel the same.

Brian Rafn: Okay. All right.

Jim Lines: It depends on the complexity of the bid and what order of magnitude the opportunity sets for us. Subs are on a rough order of magnitude 50% to two-thirds of what a carrier opportunity set is.

Brian Rafn: Okay, that's fair enough. If you look at the Navy business from an engineering standpoint, a lot of times you see in the Air Force that you're changing specifications constantly, being very fluid on the engineering side. Is the Navy from that standpoint different than your other customer end markets, be it energy or chemical/petrochemical? Or are you constantly having engineering changes, drafting and design changes in all of your end markets?

Jim Lines: Well, we have engineering churn in our end markets quite commonly, and we talked about that in our prepared remarks. With the Naval work, when there is a new generation vessel coming out, there is going to be engineering churn. Once the program is underway and it becomes more of a build-to-print type of production process, there is of course less engineering churn, but all the way through this, whether it would be first-generation or ongoing vessels after that, there is a very huge project management activity that goes around these orders, which is more complex than our core business.

Brian Rafn: That's what I'm looking for. And then one, Jeff, you mentioned a little bit about capitalized multiples of EBITDA. How would you say that real expensive tier is priced in the acquisition area? What are you finding in some of the areas that maybe have a little less multiple? I'm looking for more of a numeric range.

Jeff Glajch: Sure. When we did our acquisition a few years back, at the time we paid six times EBITDA and with the earn-out, it ended up a bit lower than that. I would say that the ranges we're seeing now are certainly a little north of that. Some of it is too pricey, but in the markets that we're looking, although they're certainly north of where we were in that last acquisition, the ranges are not out of line.

Brian Rafn: Yes, okay. On that, Jeff, are you seeing some of that pressure? Are you seeing a number of strategic business buyers? Or are you seeing some of the financial buyers, be it private equity or whatever, driving up some of those multiples?

Jeff Glajch: Sure, that's a great...

Karen Howard: Just before you answer, Brian, I'm going to ask that after Jeff answers this one, if you could get back in queue if you have a few more questions?

Brian Rafn: Sure.

Jeff Glajch: Brian, we're seeing both. We're certainly seeing strategic buyers and we are also seeing activity on the private equity side that might be driving prices up a little bit. But we're seeing a mix of buyers in the market today.

Brian Rafn: Okay. Thanks, guys.

Jeff Glajch: Thank you, Brian.

Jim Lines: You're welcome.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of John Bair with Ascend Wealth Advisors. Please proceed with your question.

John Bair: Thank you. Good morning, Jeff and Jim. My question pertains to the international area. It looks like overall, backlog and orders are really well-balanced. If that international side picks up, where do you think that would predominantly come from? I know you had mentioned previously about refining areas internationally. But, is there any particular area that seems to be more encouraging than others? Europe versus Asia or vice versa? Or South America?

Jim Lines: The areas where there is active bidding going on for us, are Asia, Middle East, South America. And it's refining and petrochemical/chemical and some alternative energy.

John Bair: Okay. Are there any new market areas that you're looking at, either from the acquisition standpoint or as an expansion of your existing capabilities? Are there other markets that you could serve that are maybe parallel to or somewhat different from what you've got going right now?

Jim Lines: Sure, there are. If we peel back, though, and think about what we've conveyed, we're focused on engineered-to-order products, long sales cycle applications where product performance failure is a very extreme problem, value-based decisions. We find that principally resides in the energy markets or those very closely related to those markets, very closely adjacent to those. We've been looking at how we can leverage our core competencies of that sales cycle, our sales channel, and our operations model. We're principally staying very close to our knitting.

John Bair: Okay. Very good. Thank you.

Jim Lines: You're welcome.

Operator: Thank you. Our next question comes from the line of Gabriel Birdsall with Brasada Capital Management. Please proceed with your question.

Gabe Birdsall: Hey guys. How are you doing?

Jim Lines: Good morning, Gabe.

Jeff Glajch: Good morning.

Gabe Birdsall: Thanks for your time. Real quick, I just have a few questions. On slide 13, it's been out there for awhile, you're exceeding $200 million in organic revenue this cycle. I'm curious. When did you first put it on, two years ago or so?

Jim Lines: Yes. Two years ago in October.

Gabe Birdsall: How has the composition of that changed since you provided it? Meaning, what end markets or geographies are now getting you to $200 million-plus? Has that changed much?

Jim Lines: It really hasn't changed much, if we think about the building blocks now versus the building blocks as we envisioned them two years earlier, they really haven't changed. If you think about how we've diversified with our power sector strategy and our ongoing defense strategy, those are two very important building blocks. In a rough, high level view, how do we go from $100 million to $200 million with our organic products?

The defense strategy as we mentioned, should we be successful as we get into the cycle, we think that represents 15% to 20% of our sales mix, round numbers $30-ish million. Our power sector strategy, which wasn't part of our growth strategy in 2005 through 2009, we think that's in the 15% to 20% of sales mix. The remainder is traditional refining, petrochemical/chemical. That will come from taking market share; we left some share on the table last cycle because we couldn't execute it.

The customers wanted to work with Graham, however we were execution-limited. We spent a fair amount of money, resources and time the last four years to resolve that constraint. The team has done a very good job. As we conitnue into this current cycle, I am expecting we'll take more share and push the core segment of our business higher. The building blocks basically are the 25% to 35% of the $200 million that comes from markets we didn't have before. The rest is that we drive our core markets stronger and take more share because we can execute so much differently today than we could last cycle. I don't think we are market-limited.

Gabe Birdsall: Thank you for that. My next question is on the backlog. It's so strong and so robust. I think when you've had calls in the past, you've talked about investments that you were already making in anticipation of this cycle. Is that correct?

Jim Lines: Yes. Yes.

Gabe Birdsall: So you've already pre-spent dollars, so to speak, for future business?

Jim Lines: We did. We got ahead of it. I'd say we were at it very actively the last three years while revenue was flat at basically $100 million and income was flat basically $10 million to $11 million. We poured a lot of investment into our business in anticipation of what we strongly felt would be a strong growth cycle. I still feel that's going to play out and it does begin to show itself in 2015 with a growth between 17% and 27%. We are expecting growth after 2015 into 2016, of course. I feel very happy that we made those bold decisions two to three years ahead of demand, so we have the dry powder.

Gabe Birdsall: Very fortuitous. We agree. So everything in your backlog you would characterize as good-margin business. Is that fair?

Jim Lines: Yes.

Gabe Birdsall: I know this was asked earlier. Help us understand how conservative you are being on your margin assumptions going forward, given good margin in the backlog already, and that you've already been investing for the last three years in anticipation of this ramp. How conservative are these margins for 2015?

Jim Lines: At this point, our belief is that they range between 30% to 32% on average. What are we doing, what are we doing to eke that higher, what can happen? We've mentioned that of our $112 million backlog, about 70% to 75% of it converts this year, roughly $80 million. Therefore, another $40 million to $50 million has to be won yet. We are aggressively pursuing that, but we are seeing an improvement in the pricing environment and the margin coming into the backlog with new orders. It depends on what we win, the margin profile of that, and how quickly we can get that into production. So that's not unusual.

Also, the ongoing execution and the benefit we have from our strategies around the short-cycle business, the more predictable, less variable business as we see that grow in volume and inch up in margin, that has an impact. Then our operations team and their committed focus on productivity and lead-time reduction, leveraging the assets we have. You couple all of these strategies together, is there upside? Yes. Are we conservative in the 30% to 32%? Not with what we see right now, however, we are going after making that stronger, we're not happy with that.

Gabe Birdsall: And a question I've asked numerous times in the past, correct me if I'm wrong, you generated roughly $10 million of free cash flow for the trailing 12 months?

Jim Lines: Right.

Gabe Birdsall: That's right? Okay. You're left with over, just round numbers, 20% of market cap in cash and no debt. What is considered excess cash to you guys?

Jeff Glajch: I would say from an operations standpoint, the vast majority of that would probably fall into that category of our $60 million. However, as we look to utilize that cash for investments, particularly on the acquisition side, we'd like to certainly use that cash in that regard. We don't need $20 million, $25 million to operate the business. Certainly around 15% to 20% of our cash flow would be more than sufficient, but we would like to keep the dry powder available for acquisitions.

Gabe Birdsall: Sure. Are there any one-time additional things that you'll spend in CapEx for this next 12 months, over and above what you've already been spending, call it $2 million to $3 million per annum?

Jeff Glajch: Just the completion of our expansion here in Batavia, which again, about half of it has been spent so far and the rest of it will be spent quite frankly over this quarter and maybe into the second quarter of the fiscal 2015 year and then it should be done. Beyond that we've got our normal $2 million to $3 million of capital, maintenance capital, and improvement capital.

Gabe Birdsall: You're going to come in generating another $10 million to $15 million of free cash, when the year is all said and done. You'll be at $70 million-plus in cash. You've talked about acquisitions and you've done some great ones in the past, and you do have a small dividend. It'd be nice to see you get a little more aggressive on doing something with this cash, particularly where you are in the cycle. You've said before you are at the 2004, 2005 type time period. You are right in the front of this big lift here. It just seems like, and you've been great stewards of it in the past, but it would be nice, just from my standpoint, to see something a little more aggressive.

Jeff Glajch: Sure, Gabe. We certainly understand. Getting the yields that we are getting on our cash right now is not something that we're particularly pleased with.

Gabe Birdsall: Okay. Thank you very much for your time.

Jeff Glajch: Thank you.

Jim Lines: Thank you, Gabe.

Operator: Thank you. Mr. Lines, there are no further questions at this time. I would like to turn the floor back over to you for any closing or final comments.

James Lines: Thank you, Melissa. We appreciate your time this morning, and the questions that you did have. Hopefully, you share the enthusiasm that I have as we go into fiscal 2015. We're moving forward well, we're going to have strong growth, and the market fundamentals and the investments we've made in our business are coming together at the right time. And Graham is a good story as we go forward. We look forward to updating you end of July. Thank you.

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