

Operator: Greetings and welcome to the Graham Corporation Fourth Quarter Fiscal Year 2013 Financial Results conference call. At this time, all participants are in a listen-only mode. A brief question and answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this call is being recorded.

It is now my pleasure to introduce your host, Karen Howard. Please begin.

Karen Howard: Thank you, Brenda, and good morning, everyone. We certainly appreciate you joining us here today for the Graham Corporation Fourth Quarter Fiscal Year 2013 conference call. On the call, we have James R. Lines, President and CEO, and Jeffrey F. Glajch, Chief Financial Officer. Jim and Jeff will be reviewing the results of the quarter and then we will handle the Q&A session afterwards. They will be talking to the slides that you should have, but if you don't, you can get them on the Company's website at www.graham-mfg.com.

As you may be 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 was stated here today. These risks and uncertainties and other factors are provided in the earnings release, as well as with other documents filed by the Company with the Securities and Exchange Commission. You can find these documents on the Company's website or at www.sec.gov.

And with that, let me turn the call over to Jim to begin the discussion. Jim.

Jim Lines: Thank you, Karen, and thank you to everyone that joined our webcast to review fourth quarter results. Please refer to slide 3.

Our strategy across this next expansion cycle in our markets is to double revenue and exceed \$200 million at the next peak. We believe our focus in the energy markets with engineered-to-order, custom fabricated products and our commitment to the Naval Nuclear Propulsion Program will provide sufficient demand to realize this strategy. Our plans to accomplish this include taking greater market share in refining and chemical/petrochemical markets; extending our supply to the Naval Nuclear Propulsion Program to include equipment for submarine programs; capitalizing on what is expected to be substantial investment in new chemical and petrochemical capacity in North America, driven by low cost natural gas; expanding our presence in power generation markets, including nuclear, geothermal, biomass and other renewable energies; and putting our balance sheet to work to drive both organic growth and growth from acquisitions.

Please move on to slide 4. We had a solid fourth quarter. Our team, management and employees together executed exceptionally well. Actions taken in the second and third quarters to drive revenue and profits in the fourth quarter came to fruition as planned. It was a terrific effort by the whole team. Fourth quarter sales were just shy of \$31 million, up \$10.7 million from a year earlier. When compared with the second and third quarters, fourth quarter sales are up approximately 20%. Full year sales were \$105 million, midpoint of our most recent guidance and at the lower end of the guidance provided at the start of the fiscal year.

Operating margin in the fourth quarter was 18.4%, generating \$5.7 million of operating profit. When compared with the second and third quarters, operating profit is up more than 45%. Improvement in

profitability was driven by greater throughput and, thus, improved leverage, quality of backlog converted in the fourth quarter and timing of refining industry backlog conversion. Full year operating margin was 14.5%, generating \$15.3 million in operating profit.

Net income in the fourth quarter was \$4.1 million and, for the full year, it was \$11.1 million. Our bidding activity remains elevated. I continue to believe this is a positive leading indicator for the direction of future orders and subsequent backlog expansion.

Please refer to slide 5. Let me offer a little more detail into the quarter sales. There has been a surge of refining market spare or replacement parts orders that we began to identify about one year back. Certain of those orders contributed to the fourth quarter sales and profitability. The level of spare parts sales in the quarter was roughly two times what is ordinarily expected.

Sales to the refining market were \$13.7 million, driven in part by the step up in spare parts, but more importantly, by orders for new capacity in China. Power industry sales were \$7.3 million and sales for the nuclear power generation market were roughly 75% of those sales. Chemical and petrochemical market sales were just under \$5 million. Fifty-three percent of sales were domestic and forty-seven percent were international. Sales to Asian end users were 20% of quarter sales and to the Middle East were 11% of sales. Full year sales were \$105 million, again 53% domestic and 47% international. Asia and the Middle East markets were 16% and 14% of sales, respectively.

I am going to pass it over to Jeff for a more detailed review of financial results. Jeff?

Jeff Glajch: Thank you, Jim, and good morning, everyone. If you would turn to slide number 7, as Jim mentioned, sales were up in the fourth quarter by just over \$10.5 million, primarily driven by increased refining sales. We also saw increases in the power markets and in our other commercial and industrial markets, with a slight decline in the petrochemical market. We saw growth across all major geographic regions.

Our gross profit increased from \$5.2 million to \$10.5 million, doubling year-over-year. The growth in gross profit was driven by two things: obviously, the sales growth increase of over 50%, and then on top of that, our gross profit margins increased from 25.6% up to 34.1%. The increase in gross profit margin was driven by the capacity utilization and the additional volume, as well as a very favorable mix, with higher aftermarket sales in the fourth quarter of fiscal '13. The improvement in gross profit dropped down dramatically to operating profit and our operating profit margins, as well as, obviously, our EBITDA margins. As you can see, our EBITDA margins were 20.1%, or \$6.2 million, in the fourth quarter, up from \$2.1 million and 10.5% last year.

On the next slide, if you look at the full year results, you'll see that our sales increased from \$103.2 million up to \$105 million, up approximately 2%. As we've discussed on previous calls, we saw a significant shift year-over-year, where, in fiscal '12, the first half of the year was stronger and the second half of the year weaker, and then in fiscal '13, the first half of the year was slower and it picked up dramatically in the second half of the year. This affected our gross profit margins, which were down slightly in fiscal '12 to fiscal '13, and that drop was really driven by the first half of fiscal '12 when we had extraordinary margins related to some refining projects in the Middle East that had been won with pricing at the top of the last cycle. Gross profit in fiscal '13 was \$31.8 million and a gross profit margin of 30.3%.

Our EBITDA margin in fiscal '13 was \$17.3 million and 16.5%, again down slightly from last year, driven partly by the slight decline in gross profit, as well as the additional investments that we've put forward in our business as we anticipate future market growth.

Cash flow in fiscal '13 was very strong. Cash flow from operations was \$12.4 million in fiscal '13 compared with \$2.6 million in fiscal '12.

Turning to the next slide, you can see our earnings per share was \$0.41 in the fourth quarter of fiscal '13, up from \$0.04 in the fourth quarter last year. Fourth quarter last year did have an R&D-related tax settlement charge of \$0.04, so, on an operating basis, we're really comparing \$0.41 to \$0.08. Full year EPS was \$1.11 versus \$1.06 last year, up \$0.05, and while the increase was driven by a slight improvement in revenue. We also, as I mentioned earlier, have pre-invested in fiscal '13, which adversely impacted fiscal '13 earnings, and we're pre-investing for growth that we see going forward.

Finally on slide 10, you can see our cash position continues to be very strong. We continue to have no bank debt. We have \$51.7 million in cash, up \$10 million from last year, driven primarily by our cash flow from operations, offset slightly by capital spending and dividend payments. Our cash position is very strong. We also have a \$25 million line of credit, which is expandable to \$50 million with Bank of America, so clearly we have a significant amount of dry powder to utilize for organic investments, as well as the financial flexibility to support our ongoing acquisition strategy.

With that, I'd like to pass it back to Jim.

Jim Lines: Thank you, Jeff. Please move on to slide 12. Fourth quarter new orders were \$25.9 million, a 39% decrease from an unusually strong fourth quarter one year ago that included a large order for U.S.-based new nuclear power plants. Fourth quarter bookings were in line with the second and third quarter order levels. Domestic orders represented 58% of total orders in the quarter.

Recovery in our markets has been moderate thus far and quarterly bookings levels have been in the \$25 million range the past three quarters. That is below where we thought they would be by now; however, if we consider the level of bidding that has been done, it is substantial. The value of our trailing 12 months of quotation activity is between \$750 million and \$1 billion. This is more than twice the level prior to the start of the 2005 through 2009 expansion cycle. I view this as a leading indicator that is quite positive.

On to slide 13. Backlog is \$85.8 million as of March 31st. We expect 75% to 80% of it to convert within the next 12 months. There are long-lived orders in backlog, specifically the order for the Naval Nuclear Propulsion Program and those for U.S.-based new nuclear power plants. This is why we project 75% to 80% backlog conversion during the next 12 months. Backlog breakdown is 40% for refining markets, 25% for power generation industries, 8% for chemical/petrochemical markets and 27% for Naval work and other markets. We do expect order rates to begin to pick up; however, they will likely remain choppy.

Slide 14. Fiscal 2014 guidance is for revenue to be between \$100 million and \$115 million, gross margin between 29% and 31%, SG&A at 15% to 16% of sales, and a tax rate of 33% to 34%. Orders in the first and second quarters of this fiscal year will define if we move to the upper end of the range or perhaps higher. I will update you on this in July.

Slide 15, please. Our strategic focus is on sustainable earnings growth. We plan to do this by taking

greater market share, expanding into submarine programs and leveraging our balance sheet to drive growth. We're also focused on reducing earnings volatility. We will do this through elevating the level of less cyclical orders and diversifying our customer base. Improving operating performance is a key strategy for us. We have a keen focus on error elimination, process improvement and aligning processes to reduce lead time, leveraging existing physical plant assets and investing to improve productivity. Strong cash flow from operations will be realized by work of the entire team focused from the start on the quoting process, where cash flow terms are negotiated, to operations, reducing lead time and working capital, through to collections.

A strong commitment to our customers and in developing our workforce is a key strategic focus. Our customer is first in everything that we do. We go to extraordinary lengths to be the supplier of choice by serving customers better than any competitor. Our employees make that happen. Our management process, to engage them in creating our success and by having our Company be where employees want to build careers, has magnified our success and will drive it going forward.

Brenda, please open the line for Q&A at this time. Thank you.

Operator: Thank you. We will now be conducting a question and answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate that your line is in the question queue. You may press star, two, if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. Once again, please press star, one on your telephone keypad if you have a question at this time.

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: Morning, Chase.

Chase Jacobson: Jeff, I think this first one's for you. Just on the aftermarket in the quarter, can you give us any color as to how much the aftermarket sales actually were, and maybe some general comments on how the margin profile compares with the OE business; and then was there something specific on specific projects that drove those better sales, or just any color around that?

Jeff Glajch: Sure, Chase. If you think about our aftermarket business, normally, it is about 30% of our overall business. It was up pretty significantly from that. The margin on our aftermarket is also significantly greater, so really, without giving too much on specific numbers, the mix of the two, the higher percentage of it and the fact that it is always our highest margin business really gave us a nice bump up in gross profit margin in the quarter.

Chase Jacobson: Okay. I mean, there are some equipment companies that say their aftermarket is double the gross margin of their OE business. Is that a fair assumption to make?

Jeff Glajch: No, it's not that high. It's certainly quite a bit higher, but no, double would be way out of line.

Chase Jacobson: Okay, that's helpful. And Jim, on the bid pipeline, obviously it's still strong at \$750

million to a billion. What's different than before that caused you to widen the range of that, because I think previously you said \$800 million to \$900 million? So I'm just trying to get a sense of what's different compared with last quarter.

Jim Lines: That's a good question, very perceptive. What we did this time is we've laid in Energy Steel. The prior remark related to traditional Graham, the old Graham prior to the acquisition of Energy Steel. But in rough numbers, Chase, Energy Steel adds about \$100 million of trailing 12-month bid activity.

Chase Jacobson: Okay. But on the lower end, does that have to do with material pricing? I'm just trying to understand why it's lower.

Jim Lines: Actually, to be honest with you, there's no particular reason to have broadened that range. It's probably a little safer than it really is.

Chase Jacobson: Okay. Okay, and then one more and I'll get back in queue. Looking at your guidance range for revenue and your expectation of what's going to come out of backlog, it looks like you have roughly 60% of the guidance range in your backlog now. The midpoint of the guidance is kind of like flat revenue. So, is there conservatism there? Basically, does it have to do with the timing of the new orders that you're expecting or does it have to do with the timing of what's coming out of backlog? I'm just trying to get some color on how we should expect the revenue and earnings trajectory to play out throughout the year and how that relates to your current backlog.

Jim Lines: Sure. It's an anticipated question. It's an awkward point in time for us, when you look at the juxtaposition of the quotation activity and the timing for which we need the orders to be secured and into backlog for conversion across this coming fiscal year. If we look at the last four quarters, our order levels were \$96 million. If we look at the last three quarters, the order rate had been \$25 million plus or minus a little bit each quarter. We're expecting that to expand quite well as we move forward; however, the critical time for us, Chase, is this quarter and next quarter to position the year to drive to the upper end of the range or perhaps even farther.

Chase Jacobson: Okay.

Jim Lines: However, if we have, for the sake of three months, soft bookings in the first quarter, that could drive us to the lower end of the range. It's a timing issue and then we have to come out with guidance for the full year right now, realistic relative to what we look backward at versus what we see in our pipeline, and that's a matter of timing, Chase. So we're at a tough point and we will update more definitively on the July call when we see how this quarter plays out for new orders. It's beginning to get more frothy, with a lot more excitement from our customers and from our sales guys; however, until we book it, see it in backlog and understand the conversion schedule, we're just at a tough point going out with a more aggressive set of guidance. Once we have one more quarter behind us, I'll be more definitive and perhaps give more clarity on where that guidance should be.

Chase Jacobson: Okay. That was kind of what I was expecting, so I appreciate it. I'll get back in queue. Thanks.

Jim Lines: You're welcome.

Operator: Our next question comes from the line of Dick Ryan with Dougherty. Please proceed with your question.

Dick Ryan: Thank you. Hey, Jeff, with fiscal '14, how should we look at the first half and second half? You've given us a feel in the past; how do you think these will roll out?

Jeff Glajch: Sure. Dick, I think we gave a pretty broad range and, as Jim mentioned in answering some of Chase's questions, the upper end of the range is achievable if orders in the first half of the year are strong. If orders aren't as strong, then we're more likely in the lower end of the range. One way to think about it is the orders over the last three quarters have been relatively consistent, around the mid-20s or so, so as you look at that, you could consider the first half of the year to be fairly in line with that. Then, if the orders pick up, you should see a stronger second half; if the orders don't pick up, then the second half is likely to be in line with the first half.

Dick Ryan: Okay. Jim, you mentioned one of the goals, obviously, taking share in refining and petrochemical. Have you seen evidence yet of you taking share, or what are your general thoughts on the competition?

Jim Lines: This is a look-back comment; my answer to that would be, yes, through the down cycle, my perspective on it is we took share. We not only defended our market share, but I think we advanced our market share as we capitalized on what work was available. As we go into this expansion cycle, the type of projects that we see, the relationships that we've built through the bidding process, and the end user decision criteria for who they select, I firmly believe going forward we'll continue to take more market share. It's easy to look backward and say we did, but there wasn't much activity in the marketplace, so we were very aggressive to win that work.

What really will be important, Dick, is, as we go forward and we win this chemical/petrochemical work in North America and some of the global refining work that we're seeing, that will be the evidence going forward, and in an expansion cycle, we are taking market share, and that's where it's going to be more meaningful than doing so in the downturn. But I would submit that we did take market share in the downturn, both in petrochem/chem and refining markets.

Dick Ryan: Okay, thanks. Say, on the Energy Steel side, you included that in the bid pipeline this time around. What are you seeing there, and in particular from safety programs with the aftermath of Fukushima, are we seeing any funding coming through for such programs?

Jim Lines: Finally, yes. We thought we would have seen it by now; however, the assessment of the NRC regulations as it relates to Fukushima, that's starting to materialize in customer RFPs, so we are beginning to see that now. We are also involved in some activity and bid work, Dick, for additional equipment for the U.S.-based new nuclear power plants, that's fairly sizable. Those orders are fairly sizable and the vendors will be selected over the next three to six months for that work. So we're seeing activity pick up, we're seeing Fukushima bleed through into the bidding activity finally, and in general, we're seeing, as I commented under Chase's question, a trailing 12-month bid activity of about \$100 million for Energy Steel-type products, the nuclear products.

Dick Ryan: Is any of that being generated internationally or is it pretty much all domestic?

Jim Lines: Some of it is international, but, to be candid, your second comment is probably more

accurate, it's largely domestic.

Dick Ryan: Okay, great. Great, thank you.

Jim Lines: You're welcome.

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

Jason Ursaner: Good morning. Congrats on a strong quarter.

Jim Lines: Thanks, Jason.

Jason Ursaner: I just have a couple of follow-up questions about orders and the guidance. Other than Q4 last year, orders haven't topped the \$30 million level since the last cycle really, and that level has always seemed like a pretty key threshold for operating leverage. You've talked a lot in the past about getting to it and mentioned the second half didn't come in quite where you thought it would be at this point. So just looking at your bid activity, what type of timeline would you expect you'll need to achieve more of a sustainable \$30 million per quarter level of order rate?

Jim Lines: My sense - and you've probably picked this up over the last several quarters that this has been my sense each time we've had this question - is it's right in front of us. I wouldn't expect it to not have materialized by the fourth quarter. It seems to be getting pretty frothy. Our operations and sales teams are pretty frenzied trying to understand the order timing and the execution strategies for the work that seems to be coming pretty shortly. Now, we still have to win it and get it into backlog, but I'll use the adjective, it's getting a little frothy out there for us and it's pretty exciting.

Jason Ursaner: Okay, and what do you think is pushing it out or getting the bids to not translate into firm orders?

Jim Lines: I think it's the ordinary flow of these very large, massive projects. Just to put it in context, these ethylene plants, propane dehydrogenation plants, fertilizer plants in North America really just came into vision about a year ago, and from concept to feed to EPC bid, that has a normal time span. We're seeing those now in EPC bid or the EPC has won it, and now we should begin to see it accelerate to orders being placed. What is exciting to us is the end users are trying to be the first to market, in some cases, so they're starting to move more quickly, because they want to get their plants up and running before the competition, and that's reminiscent of 2007 and 2008.

Jason Ursaner: Okay. You mentioned this juxtaposition between bid activity and this frothiness and excitement in the market with what you actually have in backlog, so just looking at the lead times on your equipment and with that visibility, when you look out to fiscal year '15, would you expect something closer to that \$30 million a quarter to be the lower bound on revenue at that point, or could it still take longer than that?

Jim Lines: From our planning premise, that's a fair way to categorize it. Again, I hate to use the timing of orders as the lynchpin there, but it is; however, our planning premise is in alignment with what you've just said or greater.

Jason Ursaner: Okay, that's it for me. Appreciate the details.

Jim Lines: You're welcome.

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

Joe Mondillo: Good morning, guys.

Jim Lines: Morning, Joe.

Joe Mondillo: Just to jump on that last question, you pointed to several different types of projects that are pretty much related to your petrochemical business, and I understand that you are anticipating this coming, but we have seen backlog down four or five straight quarters, but just so I'm clear, it sounds like you're anticipating that the bottom in the backlog was in the fourth quarter or maybe here in the first quarter and that we should expect that backlog within the petrochem to begin to tick up.

Jim Lines: That's our expectation and that's our read on the market dynamics, and that's our assessment of how our customers will act as this moves forward. This seems very real to us. The dialog with the customers is very candid, very direct and it feels like, hurry up, get ready. However, until it's booked in backlog, all I can offer you are these comments.

Joe Mondillo: Okay. In terms of the gross margin and the dynamic between the aftermarket and OEM, I understand the fourth quarter was largely driven by the weighting of aftermarket. How have orders been trending, or what is the mix like between the aftermarket and OEM?

Jim Lines: We've had a nice uptick in aftermarket beginning about one year ago, principally in the refining market, and let me just give a perspective on that from my point of view. We saw this also in 2007 and 2008, where we had an uptick in refining aftermarket work. At that point in time, in 2007/2008, it was so important for the refiner to be on stream producing gasoline, they couldn't afford to have an unscheduled shutdown, so we saw them making investments in spare parts and upgrading their equipment to stay on stream for longer periods of time.

As we look at it today, we're seeing metallurgical upgrades, replacement of equipment with a genuine desire of the refiner to have six- to eight-year run rates between scheduled turnarounds instead of four-year run rates between scheduled turnarounds, so we've seen a very nice uptick in orders as a result of that. I think there's a potential to sustain that at a nice level; however, we still need to see some of that get into our backlog, but it does feel very good from that point of view. As Jeff had mentioned, aftermarket in general has a somewhat higher margin than the new equipment orders.

Moving to the new equipment orders, if I contrast last year to this year, the margins of what we've been winning are superior to what went into the backlog a year ago, and comparing what left backlog in fiscal '13 to what went into backlog across fiscal '13, the margins are up a good amount. Again, that's a leading indicator to us that the markets are getting healthier and the pricing is getting more favorable, all good signs. We're expecting this expansion cycle to play out as we've communicated and as we've planned, and as our long-term guidance has suggested, margins should begin to expand. We're not saying they're going to hit the 40% gross margin that we had last cycle. We're modeling mid- to upper-30s this cycle as we move toward and into the peak of the expansion cycle. So nothing is playing out,

out of the ordinary for us or different than how we had planned it. The only thing that's been stressful for you and stressful for us has been the timing of converting the backlog to orders.

Joe Mondillo: So just to follow up with that, in terms of the gross margin guidance that you're putting out there, it's almost exactly what you put out a year ago; and considering the improvement in equipment margins, improvement margin in the total backlog that you mentioned, is that just a case in point of conservatism or of the total sales transitioning more towards equipment as the cycle proceeds, how can we look at that? I'm just trying to figure out the upside, I guess.

Jim Lines: I think the way to think about that is there is upside. It's really not a pricing issue; it's more of a utilization or leverage issue. If we have strong order rates leading to strong revenue for the full year moving toward the upper end of the guidance, we would expect that gross margin to move above what we've guided to. If we have softer first quarter and second quarter orders, take that worst case scenario, then we would guide down to the guidance we've given.

Again, the juxtaposition of where we are today versus how this pipeline looks, we've had to come out with guidance that was sensible, and all I can suggest is, as we get through this first quarter, our visibility will be far more definitive and we hope to be adjusting guidance as we go forward, but this is how we see it today as potential outcomes on both ends of the spectrum.

Joe Mondillo: Okay, great, thanks. And then just the last question regarding your international versus domestic business. The orders over the last three quarters have increased domestically, but internationally have actually decreased over the last three quarters. Obviously, there are a lot of positive indications in the U.S. markets and everything, so could you comment on why you think some of those orders have been a little light internationally and what your outlook there is?

Jim Lines: In certain international markets—and I'll speak to China specifically—we've seen a more measured pace in China for moving forward on order decisions. The projects remain viable; they just keep sliding quarter-to-quarter. I think that's been the biggest issue for a decline in international sales, and the timing of some larger Middle East work that we have in our pipeline. That could right itself in one or two quarters based on what we see in our pipeline, but I would say, looking backward, China has been more slow and measured in releasing orders for new capacity and the timing for some Middle Eastern work just wasn't staged yet to be secured.

Joe Mondillo: Okay. Thank you.

Jim Lines: You're welcome.

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

Tom Lewis: Yes, hey, Jim, I was wondering, the aftermarket business that you were just describing, is that something that you have to go out and sell or is it more like something that the customers already understand? Is it just a matter of getting to capacity points or capacity utilizations and budgets and all that and then they call you up and want to do it?

Jim Lines: It's a combination of both. We have a service team that does go into the field and will do performance assessments of our equipment to identify where we would recommend replacement

parts be purchased or modifications to the equipment be done to improve performance, but I think, predominantly, it's the refiners going into their scheduled shutdowns and then their desire to extend the run rates from four years to a longer interval. They're making investments now to ensure that, when they're up and running, they will do their best not to have an unscheduled shutdown, which is extremely costly and undesirable for them. For us, it's been very advantageous, because we have such a rich installed base of equipment in the refining space, particularly in North America going back to the '80s, '70s and '60s, that this is just fantastic work for us.

I don't want to diminish it. We do have to go out and sell it. We have to do a lot of hard work. It doesn't just fall in our lap, but it is a bit of a customer coming to us in some cases with "We're coming down in nine months, we need replacement parts. Can you get it to us in nine months? And here's the reason why we need those parts."

Tom Lewis: Okay, so it's something that's not such a quick fix, but it's going to be done within the customer's larger scheduled downtime.

Jim Lines: Right, correct. These are normally planned about 18 months in advance. So if they're looking at a scheduled turnaround next month, it was something they thought about 18 months ago and has already been bought.

Tom Lewis: Okay, and can you give us a little color on what you expect from the Naval business and, in particular, is there a window of time that we might reasonably look to hear about a submarine decision?

Jim Lines: I think with the Navy work, or our Navy strategy as a whole, we're extremely pleased with our progress. We're doing a very good job on the carrier order we have. I can share with you that the interaction we've had with the Navy or their shipyards has been very positive on both the carrier work and potential submarine work. There are several things that they like about Graham. One is our ability to manage these complex projects, to identify design or schedule risk and implement countermeasures; if issues arise, get back on track; open candid conversations about the realities of these types of projects. So they like our contract management process. They also have identified that the quality of the workmanship that we do, the control over the manufacturing process, the quality of the product that we will deliver is extraordinary and precisely what they're looking for. Those are all very positive signs.

As I think about the submarine program and our strategy there, I would suspect, over calendar 2013, we'll be able to define, are we in the sub Virginia-class sub program or not? I think for the Ohio-class sub program, we have orders in our backlog for engineering only. That would be defined in calendar 2014 if we are a supplier to the Ohio-class program. But the Virginia-class window, I think, was calendar 2013.

Tom Lewis: Okay. All right, and then finally, as the market has progressed from depressed to what sounds like moderate but about to be not-so-moderate recovery, have you seen any change at all in your rate of winning the bids?

Jim Lines: Not yet, and that's encouraging too, because I think we're at a low ebb on dollars quoted to dollars converted, but it should only go up from here. If we look at our historical patterns, we're at a low conversion level of that trailing 12-month bid rate to orders. We haven't seen it fall consistently below where it is today. So, again, our modeling is such that that conversion of pipeline dollars quoted to orders should begin to step up. What's also very favorable - and this is important - is, if you think about the constraints that we've talked about in our business around engineering capacity, the

order sizes should begin to become larger.

And if you thought about our average order the last two or three years, this is average on the large projects that have press releases, it's been \$600,000 to \$800,000 on average; some big ones, some smaller ones, but the average was \$600,000 to \$800,000. We're in the hunt for several \$1 million up to \$5 million projects that will average that up, and again, I don't like to keep striking a contrast to 2007 and 2008, but that really lifts the business to a much higher margin potential as that order size gets larger, and for us, as management, it's a pretty exciting time to see that start to move through the pipeline.

Tom Lewis: Well, hopefully, that's something we'll be talking about in the first half. Keep up the good work.

Jim Lines: Thanks, Tom.

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

Brian Rafn: Good morning, Jim and Jeff.

Jim Lines: Hi, Brian.

Brian Rafn: A question for you, Jim. You talked about the universe of bidding business, \$750 million to a billion, roughly. As you build up the next cycle to \$200 million in sales, is there an expectation when you capture market share that you also have some internal bogie that you're going to raise the level of sales conversion from your bid quote activity, or is that sales conversion rate kind of a normal ebb and flow, and I don't know what your internal numbers are, but is there any issue to maybe raising the sales conversion rate over the next few years?

Jim Lines: We're focused on that. There's a natural improvement in conversion rate the way we measure it based on orders actually moving to being placed; however, we have spent the last three years focused on developing internal capacity. We have been an execution-limited business and we had to turn work away in our past, in the last peak. We've gotten at that the last three years. Our engineering and operations teams are more equipped today for a strong expansion cycle, so I think that, coupled with the natural improvement that comes when customers are letting purchase orders, we should have a compounding effect that should be very positive. So my summary comment here is we will take more share and we will expand our conversion of bid dollars to sales or bookings, because we're a better Company today than we were last cycle.

Brian Rafn: Yes, okay. You kind of answered my next question. Everyone in cyclical business worries about rationalizing on their downside, but you have, as you call it, frothy bid quote activity, a capacity shock to the upside. If you were to see a dramatic increase above the \$30 million run rate in bookings, could you sustain that or would you then have to add more manufacturing or more capex or more headcount if you really got an upside shock?

Jim Lines: Just to give it a frame, we invested in personnel during calendars '10, '11 and '12 for this potential surge of business that we see coming, but that's not quite here yet. We took the profit hit in those operating years to prepare for this strong wave of business that we see. I think we've done well

to right-size our business. I'm picking a number here, but let's say it's for \$110 million to \$130 million. There may be some incremental adds, but the big adds we've already taken care of, with the exception that our direct label will probably slide a little bit as volume goes up, but from the infrastructure, the indirects, we took care of that in '10, '11 and '12. As I said, there'll be some incremental adds, but we got at a lot of that during the last three years, while we had the profitability to do so during the downturn. What's ideal is these employees have now been with us one year, two years or three years, and they're well along on the development and training programs, so they're very valuable toward the output that they're able to generate.

In our past, we were into an expansion cycle 12 to 18 months before we began to hire. This time, we had the luxury of doing this during the downturn, so we're more ready today than in our past. So for us, as management, and for me in my role, it's extremely exciting and I'm very eager to watch how this unfolds and to see how our strategies fall out and get realized.

Brian Rafn: Okay. Jim, I think the word you used was 'choppy' relative to the order flow. Are there any endemic differences between the specific channels or your business, say power versus refinery versus petrochemical versus Naval, where some channels tend to have very fluid and very expedited orders and other channels, just by definition, tend to be very sluggish?

Jim Lines: If you think about where we play, where our brand fits and where we focus, it's where that sales cycle is long, where there's a great deal of engineering interaction between us and the customers before an order is placed, that has the tendency of a measured pace for how that work flows. So, for our refining work, our petrochemical work and certainly our Navy work and the nuclear power market, that's not urgent order placing; that's very measured, very controlled and it doesn't move too briskly. What's nice, though, is we've been working on these projects for a long time, and you've heard us comment about the enormity of our bid pipeline for several conference calls now, so a lot of that upfront time-based work, we think is underway or perhaps behind us, which leads us to believe that it's going to get active very quickly.

Brian Rafn: Okay. Let me ask you, on the Navy side, one, you made a comment on Ohio-class; you're talking about the next generation boomers, right? You're not talking about the 14 Ohio-class that we currently have, correct?

Jim Lines: I apologize. It's the Ohio-class replacement program.

Brian Rafn: The replacement program, okay. As you become, you know, in the process, you're an approved supplier, you've been providing, I'm assuming, condensers and injectors for the carriers and the next-gen SLBM ballistic fleet missile boat. Is there a process where you then have to apply for the fast attack submarine Virginia-class or is that something that you've already won, or is there some issue with that as far as being approved before you actually get into the design?

Jim Lines: Well, the design is already done, so it's entering into the Virginia-class program as a supplier for what we would call build-to-print work, and displacing the incumbent through either our quality or our ability to manage these contracts more effectively or from a cost advantage to the shipyard. We've been having discussions with the shipyards and the Navy regarding the two different sub programs since we won the carrier orders, so it's been two or three years or longer, and those discussions have been very, very fruitful. Our intent is clear to the shipyard and the Navy that we wish to participate in the sub programs, and as I said on an earlier question, I think the window for entering the Virginia-class program

should manifest itself over calendar '13, and for the Ohio-class replacement program, that's calendar '14. Our team is working extremely hard to break into the Virginia-class program.

Operator: Okay, thank you. Our next question comes from the line of George Walsh with Gilford Securities. Please proceed with your question.

George Walsh: Jim, if I'm hearing you right relative to the way you've positioned yourself for the cycle, it seems like, with this expansion, the idea of where you get to about \$200 million, do you see the SG&A margins staying flat to possibly going down relative to your sales.

Jim Lines: Right, if we look at where they are today, 15% to 16% of sales, we would expect to get leverage as we get larger and have that slide lower as a percent of sales. I don't see that area being proportionate as we grow as a percent of sales.

George Walsh: Okay, that's good. And you seem to feel good about the gross margins as you go into this cycle, that there's higher margin work out there to expand that, so it's not a matter of being more competitive as the cycle goes on and maybe having to get some tighter gross margins in there?

Jim Lines: That's correct. There is a caveat to that and it's something that we're watching. As we think about the North American chem/petrochem expansion, we're trying to understand the decision making of the end user with regard to what contractor EPC they're going to select or what turbo machinery OEMs they might select. If the EPC is international versus North American, there is a different margin potential for us, based on their supply chain, that they would be looking at our competition. The same holds true for an international turbo machinery OEM. So we're trying to understand more clearly how the end user is sourcing critical equipment. Are they focused on North American suppliers, or are they globally sourcing? And that applies to the EPC involved or the OEMs that are involved. We just don't have complete visibility to that just yet, because these orders are just now being placed, but that's something that we're watching.

All in all, with that caveat, we think the expansion of the North American petrochem/chemical market is going to be fantastic for us. We're focused on winning more than our fair share of that. The caveat I made was around margins and that reflected who our customer was.

George Walsh: Okay. All right, thanks a lot.

Jim Lines: You're welcome.

Operator: Ladies and gentlemen, we do have time for one more question. Our next question comes from the line of Chris McCampbell with Southwest Securities. Please proceed with your question.

Chris McCampbell: Wow, I just barely got it in. Congrats, Jim and Jeff, on the quarter. With such strong cash generation at this point in the cycle and interest rates as low as they are, especially with the line of credit that you have outstanding, can you give a little color on why it doesn't make sense to return more cash to the shareholders at this point, and also just some color on the acquisition environment out there? Thanks.

Jeff Glajch: Chris, yes. Well, as you know, we did bump up our dividend by 50% back in the end of January, early February, but we continue to want to utilize our cash position to allow us to go after

acquisition opportunities; and while I certainly understand the low interest rate environment, we're also pretty conservative from a balance sheet management standpoint and don't want to put ourselves in a position from a leverage standpoint that, in a future down cycle, we would put ourselves in any type of a precarious position. But obviously, between the cash we have and the availability of debt, whether it's through our bank line or through any other methodology that we would go forward with, we do have the ability not only to make significant acquisitions, but also, if the right opportunity were to come along, to do something pretty significant. That's all in consideration and we believe that the acquisition pipeline that we're seeing is pretty significant and we'd rather keep that cash and debt capacity available to take advantage of acquisition-type opportunities.

Specifically to the acquisition pipeline, we've wrapped up our acquisition process again, and as you probably recall from the last time we went through this process, it's a lengthy process, because our methodology is a lot different than a lot of companies from the standpoint that we typically reach out to companies that are not for sale. They are often private companies, but not exclusively, and a lot of the process is a courting process to convince the potential seller, who again is not for sale when we first introduce ourselves, that it is the right opportunity for them and us to find a way to work together. It's a long process, but what we're seeing in the market today are some good opportunities. Pricing is not out of line in general, and as I said, we like to keep our cash and debt capacity available to hopefully take advantage of that.

Jim has talked a lot about the \$200 million target that we've put out there. We believe that we can do that organically, so with the acquisition opportunities we have, it's two things. One, it'll allow us to get to \$200 million faster, and also, it'd give us the opportunity to get well past \$200 million if we found the right acquisition opportunity.

Chris McCampbell: Would you say the size of the candidates you're looking at has changed over the last couple of years to the point where you're looking at larger companies to acquire?

Jeff Glajch: The only change is really that we have one acquisition under our belt, and so we've gone from being a company that had not done an acquisition in about 30 years to one that has done one at the lower end of our range, but we're willing to look beyond the lower end of that range. If the right acquisition next time is a \$20 million-type company, great; if it's a \$30 million or \$40 million company, that's fine too; if it's bigger than that, that's fine also. We're not overly focused on size; we're focused on the right fit. But I would say, in general, we're willing to look a little higher than we did the last time.

Chris McCampbell: Well congrats, guys.

Jeff Glajch: Thanks.

Operator: There are no further questions at this time. I'd like to turn the floor back over for closing comments.

Jim Lines: Thank you, Brenda, and thank you, everyone, for listening in on our webcast today for our fourth quarter conference call. We appreciate your questions and your interest in Graham, and we look forward to updating you on our progress in July. Thank you.

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