Operator: Greetings and welcome to Graham Corporation's First Quarter Fiscal Year 2018 Financial Results Call. 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, Ms. Karen Howard, Investor Relations for Graham Corporation. Thank you. You may begin.

Karen Howard: Thank you, Adri, and good morning, everyone. Thank you for joining us to discuss the results of Graham's fiscal 2018 first quarter results. We certainly appreciate your time today. You should have a copy of the news release that crossed the wire this morning, detailing Graham's results. We also have slides associated with the commentary that we're providing here today. If you don't have the release or the slides, you can find them at the Company's website at www.graham-mfg.com.

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

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

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

And with that, it is my pleasure to turn the call over to Jim to begin. Go ahead, Jim.

Jim Lines: Thank you, Karen, and good morning, everyone. I am referring to the information on slide 3. First quarter revenue was $20.9 million. This was above expectations, and in line with the stretch goal that management had set for the quarter. We were able to accelerate certain projects from the second quarter into the first quarter. On a comparison basis, revenue in the quarter was down 7% compared to last year. This was due to the order pattern in the recent past several quarters. However, I do compliment the management team for positively affecting what they can control.

First quarter net income was $900,000, or $0.10 per share, compared to one year earlier, which was $100,000, or $0.01 a share. The prior-year period included about $0.5 million due to restructuring charges, so on a comparable basis, you would compare last year's adjusted net income of $500,000 to this year's $900,000.

There is still uncertainty in the downstream energy markets, principally in the refining markets, that has affected order levels and the backlog trend. First quarter orders were $11.1 million versus $14.6 million a year earlier. The order environment has indeed been challenging, not necessarily due to competitive pressure, but more due to customers unwilling to make final investment decisions, and that has affected the pace at which orders are released by our customers. Consequently, that has resulted in our backlog declining to just under $73 million at the quarter end, and of that, 64% is due to our naval strategy.

Moving on to slide 4. By end-use markets, refining sales were down about 50%. The refining market has been consistently and persistently slow. This holds true for new capacity, retrofit, and aftermarket opportunities. However, we do feel that it is not enduring, but it is the reality that we are currently facing.

We had an increase in chemical and petrochemical industry sales to $7.2 million, up just under 40% compared to last year. This was due to conversion of our U.S.-based ethylene project revamp, and also due to a new capacity project for an ammonia and urea plant in Asia. Power industry sales were down about 15%, to $4 million. Our other commercial sales, which includes naval work, was up 16% to $6.1 million.

Regionally, all regions had a decline compared to last year due to the general health of our end-markets: refining, chemicals, and power generation. In the face of this, we are not adjusting our full year revenue guidance; we are holding it in the $80 million to $90 million range.

With those introductory remarks, I'm going to pass it over to Jeff for a more detailed review. Jeff?

Jeff Glajch: Thank you, Jim, and good morning, everyone. I'd like to direct your attention to slide 6. Our first quarter sales were $20.9 million, down from $22.4 million in last year's first quarter. The domestic and international split this year was 71% domestic and 29% international, compared with last year which was 73% domestic and 27% international. Gross margin increased from 18.4% to 23.3% this year, and gross profit increased from $4.1 million to $4.9 million. Adjusted EBITDA margin for the quarter was 8%, up from 5% last year.

Q1 net income was $935,000, or $0.10 per share, compared with the Adjusted Net Income of $468,000, or $0.05 per share, last year. As Jim mentioned, we did have a restructuring of $383,000 after-tax which impacted last year's Q1 so, the reported results of last year were net income of $85,000, or $0.01 per share.

Let's move on to slide 7. Cash increased up to $75.3 million, up by $1.8 million from the end of the fiscal year, and we now have $7.71 per share of cash on hand. Capital spending was light in the first quarter at $117,000, but we still expect to spend $2.5 million to $3 million across the entire fiscal year, with the vast majority of that occurring in the second half of the year. With our cash balance of $75 million we continue to be very active in expanding our M&A pipeline, as we look to use some of that capital to grow our business inorganically.

Jim will complete the rest of our presentation, and comment on our outlook for the rest of fiscal 2018.

Jim Lines: Thank you, Jeff. I am on slide 9. During last quarter's conference call we spoke a little bit about this slide, the trend of our trailing 12-month order pattern, and the volatility of our quarterly order pattern. We indeed are in a tough order environment.

On the positive side, our level of proposals and bids has remained fairly constant at an aggregate value of between $600 million to $800 million. We are seeing the conversion of the bids to orders at an uncharacteristically low level. We have seen this before in other steep downturns that have been protracted. The bid pipeline is rich and ample, which gives us a sign of positivity. Our customers are holding onto their decisions to release orders, but eventually that does open up. So, I'm very pleased that we are active. We have high participation in the opportunities that will materialize in the coming months or quarters. I can't define when the trend will shift upwards. However, the pipeline suggests that there is a point in time in our future when that will materialize.

As a result of the order pattern, the decline in backlog, and our projection for revenue, management does continue to review carefully its costs in relation to future revenues. We are committed to a long-term strategy and long-term value creation, focused on our naval participation, our strategies around the installed base in the energy sector, the nuclear market, and having capacity and capability for the eventual energy sector recovery.

Please, move on to slide 10. Our backlog segmentation largely consists of the naval market, roughly two-thirds of our backlog being with the naval market, two-thirds of the $72.9 million. We aren't really seeing a significant shift in the conversion trend. About 35% to 40% converts beyond 24 months; about half of the backlog converts in the next 12 months; and 5% to 10% converts in year two.

Importantly, our diversification strategies have been very beneficial during this downturn. We were very fortunate because of the actions that were taken by management five to seven years ago, and they also have been very helpful as we currently deal with this harsh downturn.

Moving on to slide 11. As I said a moment ago, our guidance is unchanged. Revenue guidance is held at $80 million to $90 million. Gross margin guidance is between 22% and 24%. SG&A is expected to be between $16 million and $17 million. The effective tax rate for the year is expected to be between 30% and 32%.

Adri, I would ask you to open the line now for Q&A. Thank you.

Operator: [Operator Instructions] Our first question comes from the line of Joe Mondillo with Sidoti & Company. Please state your question.

Joe Mondillo: Hi, guys. Good morning.

Jim Lines: Good morning, Joe.

Jeff Glajch: Good morning, Joe.

Joe Mondillo: I wanted to ask you about the short cycle business of your Company. I was just wondering if there is any part of the short-cycle businesses, amongst any of the end-markets or geographic markets, which are showing signs of improvement yet?

Jim Lines: We haven't seen a trend of improvement there. It has trended down in the range of about 20% from peak of a couple of years ago. It's now flattening, but we have not yet seen it trend up. Fortunately, we haven't seen the trend down from a sequential quarter basis, so it does seem to be stabilizing. Our contact with the customer, our bid work, is still strong. Therefore, that suggests that the buying pattern should change in the near future. At this point, we haven't seen that catalyst for change in terms of the order pattern in the short-cycle work.

Joe Mondillo: Okay. In regard to your oil refining business, do you have any sense of how much longer your customers can push out the work that you do? It's been a few years now, and I think from what I've read, the crack spreads are really good, so they're continuing to run these facilities at high capacity rates, trying to squeeze out every dollar at these current crack spreads. Are we close to a period where no matter where the crack spreads are, these facilities have to do some work and take some work from you?

Jim Lines: To be candid, we are surprised it hasn't happened yet, and I don't think we are the only ones that are saying that. Many of the suppliers to this industry had expected the MRO type work to have moved forward by now, but it just hasn't.

Again, we don't believe this is something that can be enduring, or a structural change afoot. The capital spending to keep these plants up and running, just basic spending like keeping the lights on and the doors open, those can be delayed for quarters, but not for long periods of time. That typically is half to two-thirds of annual CapEx, I would say ordinary CapEx, just keeping the house in order and in good shape.

Then, the other one-third to half is around growth or strategic investment. That can be more discretionary. We are seeing that being pushed to the right, deliberate conversations about that, or boards unwilling to make a higher financial commitment. However, the budgets that are allocated to classic MRO, we have to see that starting to pick up. We would expect that to pick up and we're ready for it. It's just a surprise it hasn't happened yet.

Joe Mondillo: Great. I have a question in regard to the gross margins that you saw in the quarter, certainly better than I was looking for, with revenue down, and even more so for the refining part of your business as a percent of sales, which was pretty much cut in half from a year ago, at the lowest percentage in many years. I was just wondering if you did anything differently throughout the quarter to drive that profitability, even with your high-margin refining business that low as a percent of the total.

Jeff Glajch: Joe, this is Jeff. We had a little bit of favorability in project mix, but the bigger thing that we had was timing of period costs that were favorable to us within the quarter. That really nudged our margins up a good amount, probably above what you had expected.

As you saw from our guidance, it is unchanged, and despite a slightly higher margin in Q1 than perhaps you might have expected, or that we had planned for, the reality is that the rest of the year is not favorably impacted by this.

Joe Mondillo: Okay. In regard to your guidance, specifically the SG&A part of the guidance, if you annualize what you did in the first quarter, you come in below that guidance. I suspect, given what you pointed to for the second quarter and given the light revenue that you're anticipating from the backlog, that SG&A could potentially be even lower than where we saw it in the first quarter. So, by mid-year, we're going to be running well below that $16 million to $17 million run rate that you have out there in terms of the guidance. Is there some downside, or could the SG&A possibly come in lower than what you're guiding to?

Jeff Glajch: Joe, good question. You're right. Our SG&A in the first quarter was about $3.7 million. Generally, we see our SG&A in the first quarter of many years being at the lower end, which is really a function of the fact that some of the activities that we start out in beginning of the year tend not to be as heavy from an SG&A standpoint.

I'm not sure I would necessarily correlate the challenges that we have in the second quarter from a top line and margin standpoint to see our SG&A down. However, as we look at our SG&A guidance, certainly, if you annualize our sales in the first quarter, you get below the midpoint of our guidance. SG&A will probably be in line. We still expect it to be within the $16 million to $17 million range, but it will be a little bit variable relative to where we end up from a revenue standpoint.

For the lower end of our revenue guidance, it is probably going to be at the lower end in SG&A, and same thing for the higher end of revenue guidance. However, I wouldn't read too much into the first quarter SG&A, and I wouldn't multiply it out by four. I think, if you went back and looked at last year, you would have seen a very similar pattern. If you adjust out that one big item that we had in the second quarter last year, the insurance settlement, you would have seen the first quarter SG&A pretty low and then by the latter part of the year, it was a little bit higher.

Joe Mondillo: Okay. Looking at the second quarter, would you suggest SG&A lower than the first quarter, just given the lower revenue that you're expecting?

Jeff Glajch: Not necessarily.

Joe Mondillo: Okay, okay. I just had one last question regarding the carrier program. I was wondering if you could update us on what you're hearing regarding that. I'm guessing you're still waiting on that bid, but any update on that would be great.

Jim Lines: On a positive note, we hear that our customer has received their order from the government, and that was a key pivot point for them to be able to be in a position to move to award some orders for CVN80. We're having conversations, we're expecting that negotiation to begin in this quarter, and vendor selection in this or the following quarter, and we hope to be successful.

Joe Mondillo: Okay, great. Thanks a lot. Appreciate it.

Jim Lines: You're very welcome. Thank you.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Bill Baldwin with Baldwin Anthony Securities. Please state your question.

Bill Baldwin: Good morning, Jim and Jeff.

Jim Lines: Hi, Bill.

Bill Baldwin: I have a couple of issues here that I'd like to talk about. Some of the geographical areas where you're down quite a bit in business in the last few years have been the Canadian area, Asia and the Middle East. Is the nature of your business in those markets such that there could be any dynamics that would be a catalyst for improvement in those areas in the coming 12 to 24 months, based on the type of business that you normally do there?

Jim Lines: I'll cycle through these three that you had mentioned.

In Asia, we're seeing a stronger opportunity set that starts to materialize in terms of bids that we've made, and our ability to predict when those orders will be placed. Therefore, several quarters out, we are expecting to see an increase in order activity and sales activity in the Asian market. So, that's just the nature of their procurement pattern and bidding at a point where they're prepared to expand capacity in their energy sector.

We think Canada is going to be a repair/replacement opportunity for us. We don't expect to see new capacity up in the oil sands for some period of time at the current price level of oil. They would need to see a higher level of oil. However, once they have their facilities up, running and operating, we will stay focused on asset integrity and reliability, which has always created opportunity for us for some sales. We do have a few bids that we've made to the Canadian oil sands, what we would call retrofit work which, notwithstanding where the price of oil is, they tend to go ahead. So, we're very excited about that.

Then, the Middle East came off of a very large capital plan. They added 300,000 to 400,000 barrel per day at the refineries, and they are on the back-end of a large petrochemical plant expansion over about the last decade. So, they're digesting a fair amount of that. We are reading that the next wave of investment and diversification by Saudi Arabia, out of oil into value-add petrochem, is starting to stage. We don't see that in the next 12 to 24 months, but we see that further on the horizon. We think that is just taking its normal ebb and flow of how they do capital and expansion projects in the Middle East.

So, it's a bit of a timing thing. If we look at the markets more over a longer period of time, we feel they're taking their ordinary supply and demand based pause, with new capacity investments coming out on the horizon.

Bill Baldwin: Very good, Jim. Thank you. On the positive side, I've seen your business pick up in the last few years in South America and Mexico. Are those trends likely to continue or stabilize, or how do you see those markets over the next one to two years?

Jim Lines: That was a very positive result of action that management had taken. We've put a territory manager in the South American market, and he and others have spent a lot of time in that territory, getting very close to the nationalized oil companies. We derived a great deal of benefit from that. We had a massive amount of opportunity on the table prior to this downturn. We're still staying close to those companies. We don't expect anything of material importance over the next 12 to 24 months, just by the virtue of where those nations are relative to be able to invest in new capacity. However, we've spent a lot of time to increase our participation, and increase our success capability in the Latin American market, and that was driven by putting a territory manager there. We saw some very strong benefit from that.

Bill Baldwin: When you mention South America, does that also include Mexico?

Jim Lines: Yes. I said South America, and then I rephrased it to Latin America, which would include Mexico.

Bill Baldwin: Okay, okay. Then, on another front, it looks like it's pretty likely that the sulfur content on bunker fuel is going to come down quite a bit on January 1, 2020, I think from 3.5% to 0.5%. There are different ways of getting there, but I guess one way is for refineries to get new cokers, or upgrade what they got if they're not working right. Do you see any potential opportunity for your company in that as a result of those regulations, assuming they go into effect, which I think most people think they will?

Jim Lines: We have been watching that. We have been watching the MARPOL regulations over the last five years. It's taking a long time, but now they have finally settled on sulfur reduction from X to Y, in alignment with what you had identified. When we think about the ultra-low sulfur investment wave that was in the mid-2000s, which happened around gasoline and diesel, that investment drove demand for our products and drove capital investment to be able to drive down sulfur content. Those processes required Graham equipment, hydrocracker, hydrotreater, coker, hydrodesulfurization. They don't require our ejector systems, but they require our other equipment.

So, we are keeping an eye on that. We have been watching the MARPOL regulations for a number of years. You are right, 2020 appears to be the year that it is mandated, and that should create demand for us. We don't yet know how refiners are going to get in front of that investment, but that should be starting relatively quickly, because they're not at that standard level now.

A counter to that is, the marine vessels can move to gas-based propulsion, rather than bunker fuel. So, we need to understand the direction of the maritime vessels as well. However, as it pertains to sulfur content, that does drive demand for Graham's products.

Bill Baldwin: Generally speaking, Jim, what kind of a lead time would these refiners have if they've got a January 1, 2020, when would they need to begin start making some bids on that?

Jim Lines: 2018 and 2019.

Bill Baldwin: 2018 and 2019, okay. Thank you very much and keep up the good work.

Jim Lines: Thank you for the questions, Bill.

Operator: Thank you. Our next question is a follow-up from Joe Mondillo with Sidoti & Company. Please state your question.

Joe Mondillo: Hi, guys. Thanks for taking my follow-up question. I just wanted to get an update on your acquisition strategy and whether your confidence of getting anything done in the near-term has improved or changed at all?

Jim Lines: I believe we've shared on previous conference calls that we brought in a business development manager to work very closely with Jeff to open up the pipeline and drive the number of deals that we're beginning to look at. That has matured very well. I have a stronger level of positivity around the direction of our M&A. That is a focal point for long-term growth. I cannot speak to when something might be concluded, because we'll maintain our disciplined approach around valuation and strategic fit. What I can say is that it's consuming much more of our time.

Joe Mondillo: Okay, great. Thanks a lot.

Jim Lines: You're welcome.

Operator: Thank you. There are no further questions. That does conclude our question-and-answer session. At this time, I'll turn it back to management for closing comments.

Jim Lines: Thank you, Adri, and thank you, everyone, for your time today and your questions. We'll be very pleased to update you on our progress in the next conference call. Thank you.

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