Operator: Greetings and welcome to Graham Corporation's Third Quarter Fiscal Year 2019 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]

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

Karen L. Howard: Thank you, Dana, and good morning, everyone. We appreciate you joining us today to discuss Graham's fiscal 2019 third quarter and year-to-date results. You should have a copy of the news release that was distributed across the wires this morning. 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 on 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 period 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's my pleasure to turn the call over to Jeff to begin. Jeff?

Jeff Glajch: Thank you, Karen and good morning, everyone. Turn your attention to **Slide 4**. Sales in the third quarter were $17.2 million, which was comparable to the same period last year. We did have a $1.1 million unfavorable impact in the quarter due to the new revenue recognition standard. The impact was larger compared to what we expected entering the quarter. I noted on the prior call that we had a significant project in China, which we expected to ship in Q3. Unfortunately, it shipped on January 4th, five days after the quarter ended. Had that shipped by the end of the quarter, our revenue would have been around $20 million.

Q3 net income was $95,000 or $0.01 per share. In Q3 of last year, we had a loss due to an intangible asset impairment charge, as well as impacts related to the 2017 tax act. Without those adjustments, Q3 of last year would have been breakeven.

Orders in the third quarter were $23.2 million with petrochem and refining orders in North America and Asia being the key contributors. Our backlog at the end of the third quarter improved to a record $133.7 million, though part of the $6 million gain in backlog in the quarter was obviously due to the lower revenue level. Our backlog is evenly split between Navy and commercial projects. Importantly, the commercial backlog is nearly triple the $22.8 million low point which we saw in September of 2017. We're quite pleased with this increase in the commercial backlog.

On to **Slide 5**. As I noted, Q3 sales were similar to last year's Q3. Sales in the quarter were 83% domestic, and 17% international. In last year's third quarter, sales were 65% domestic and 35% international. Gross profit increased to $3.7 million from $3.5 million last year, primarily due to improved pricing and higher margin projects, partially offset by under-absorbed additional production costs which have been increased to support higher capacity over the next number of quarters. Gross margin was 22%, up from 20% last year. EBITDA margin was 1.1%, down from 2.1% in last year's third quarter and net income was $0.01 per share compared with an adjusted breakeven level last year.

On to **Slide 6**. Sales in the first nine months of fiscal 2019 were $68.2 million compared with $55.4 million in the first nine months of last year. Year-to-date sales were 63% domestic, 37% international compared with 67% and 33%, respectively, last year. Year-to-date gross profit was $17.1 million, up from $12 million last year, and gross margins are up to 25% from 22% last year. The increase in gross profit is due to greater volume, and the increase in gross margin is a result of improved pricing, again partially offset by the added costs to increase our usable capacity. Year-to-date EBITDA margins were 8.3%, up from an adjusted level of 5% in the first nine months of last year. Net income was $4.2 million or $0.43 per share, up from an adjusted level of $1.2 million or $0.12 per share last year.

On to **Slide 7**. We continue to have positive operating cash flow in the first nine months of the year at $8.5 million. Our cash balance is at $80.4 million or $8.18 per share. This is up from $76.5 million at the end of fiscal 2018. We continue to be pleased with our expanding acquisition pipeline, despite higher prices in that arena and we continue to hope to be able to utilize some of our cash to grow inorganically. Capital spending increased significantly in the third quarter compared with the first half of the year and it's now at $1.5 million year-to-date. We expect to spend between $2 million and $2.5 million in capital for the full fiscal year.

Jim will complete our presentation by providing more depth on Q3, our current market outlook and our full year guidance.

Jim Lines: Thank you, Jeff. Good morning everyone and we thank you for joining our third quarter conference call. I will begin on **Slide 9**. Revenue in the quarter was down slightly compared to the third quarter of last year. Revenue at $17.2 million in the quarter was below initial expectations as Jeff had said, and also down sequentially from the second quarter due to two factors.

First, shipment of a large international order was pushed into January. This particular order, due to new revenue recognition standards, followed the completed contract rather than percentage-of-completion revenue recognition accounting treatment. That was unusual. However, there will be similar completed contract revenue standard orders in the future which might cause volatile revenue trends quarter-to-quarter, when such orders are executed. This particular order, as Jeff said, has now shipped.

Secondly, certain naval market backlog conversion is slowing due to the pace at which we believe we can advance production. This is impacting revenue projections for the second half of fiscal 2019 and also fiscal 2020.

Looking at revenue by end market, revenue to the crude oil refining market was $6.6 million, up $1.2 million year-over-year. Chemical and petrochemical market revenue was down $1.3 million to $2.9 million in the quarter. Power industry revenue was up $1 million, while revenue to other end markets, including the naval market, was down $1 million.

We continue to have a concentration of domestic revenue, with domestic end markets accounting for 83% of total revenue. However, our current backlog will result in an improvement to revenue in future quarters that is for international end markets. With our recently updated revenue guidance, fiscal 2019 is projected to provide 16% to 22% top-line growth compared to fiscal 2018.

Moving on to **Slide 10**. I am pleased with the level of orders which, on a trailing 12-month basis, is up appreciably from the low watermark during the second quarter of fiscal 2017. Importantly, orders from our crude oil refining and chemical/petrochemical markets are up measurably on a trailing 12-month basis compared to trailing 12-month totals for the period ending the third quarter of fiscal 2018.

Our sales and engineering personnel continue to focus resources on key bids, and position Graham to be successful, as is evident by the slope and the value of the trailing 12-month order trend.

There has been, and there will continue to be large variation for end market order levels quarter-to-quarter. However, the best measure is the trailing 12-month trend and how much is for our traditional oil, refining and chemical/petrochemical markets versus orders for the navel market. 55% to 60% of the $123 million of orders during the past 12 months were for refining and chemical end markets.

Slide 11 provides backlog detail. Backlog on December 31st was $133.7 million and is up sequentially from about $128 million at the end of the second quarter. In comparing backlog year-over-year, last year at this time backlog was $96.2 million. Backlog for refining and chemical/petrochemical end markets was approximately $37 million a year earlier and, as of December 31st, it is approximately $57 million, or up roughly $20 million compared to last year.

Backlog for naval end markets is up nearly $16 million from a year earlier while backlog to power end markets is up $1.4 million. There’s healthy improvement in our overall backlog that is well diversified across key end markets. This provides a great base for fiscal 2020. Backlog conversion is projected to have 50% to 55% of backlog convert over the next 12 months and 30% to 40% convert to two years or longer from now.

Moving on to guidance on **Slide 12**. Consistent with our revenue guidance update a couple of weeks back, we expect fiscal 2019 revenue to be between $90 million and $95 million, up 16% to 22% from fiscal 2018. Gross margin will be between 25% and 27%. SG&A expense will be between $18.25 million and $18.75 million. We expect our effective tax rate to be roughly 20%. For fiscal 2020, we are expecting top-line growth and we’ll provide the revenue range during our next conference call.

Dana, I would ask that you please open the line for questions now. Thank you.

Operator: At this time, we will be conduction a question-and-answer session. [Operator Instructions] Our first question comes from the line of Joe Mondillo, from Sidoti & Company. Please proceed with your question.

Joe Mondillo: Hi guys. Good morning.

Jim Lines: Hi Joe.

Jeff Glajch: Good morning, Joe.

Joe Mondillo: Just to clarify regarding the delays in delivery in this quarter, on the naval side, you said that was due to pace of production. Is that production on your end or on the customer end?

Jim Lines: It's tied to how the design releases and the approvals for fabrication flow from the shipyard back to us. It's being paced more by the customer than by our execution capability.

Joe Mondillo: Okay. Considering just the Navy backlog then, is this going to just push everything out a little bit going forward?

Jim Lines: It is indeed. It's affecting the second half of 2019 and we've made that adjustment with a revision to guidance. It's also slowing revenue conversion, based upon how we first modeled internally, fiscal 2020 financial projections. We tend to deploy that available labor into other contracts, not necessarily naval contracts, but it is affecting over the next 12 months to 18 months, revenue conversion of our naval backlog and we've made those adjustments for fiscal 2019 guidance. And when we provide our fiscal 2020 revenue range, it would reflect a slowing conversion pace for that particular segment of our naval backlog.

Joe Mondillo: Okay. Is there any way you could help us rethink how your Navy backlog flows, in terms of the cadence throughout the next 18 months? I know a couple of quarters ago, you were talking about low to mid-teens area of work in fiscal 2019 and going beyond $20 million in fiscal 2020. Is that just pulled back by a few million dollars each year?

Jim Lines: Sure. That's a fair question. As we think now about fiscal 2020, which is the more relevant question, where we had been expecting to push beyond $20 million for 2020's revenue from naval backlog, we now feel it will be comparable to the revenue level of our recent past, in the mid-teens.

Joe Mondillo: Okay. The backlog at the Navy business actually ticked up a little bit. Are you continuing to find more work beyond the core work and beyond the delays in the work that you're doing right now? Because I know that has been a goal to try to maximize your work and find more work that you can do for the customer.

Jim Lines: Sure. We have continued to win new naval work. It has been additional orders for components that we previously had in backlog, so similar components. The diversification efforts to expand our participation, those are still underway. We would not necessarily comment that the additional backlog growth is tied to components because its repeat work of components that we had previously done or are working on. I'm not categorizing that as overutilization of our diversification effort that still is underway, not being realized yet in backlog growth or diversification of our backlog for the naval strategy.

Joe Mondillo: Okay. Shifting to your legacy business in oil refining and chem/petrochem. First off, what are you seeing in your short cycle part of your business that tends to be a leading indicator of what's going on, given the volatility in oil prices and just in general economic metrics recently?

Jim Lines: Sure. That's a really good question and that's not always perceptible in our commentary or the way in which we provide backlog or order patterns. But for our short cycle work, we are seeing that, if I compare year-to-date today to year-to-date at this point last year, the short cycle new orders are up between 10% and 15%.

Now that's nice but that's off of a bottom. By a comparison, they're down about 13% compared to fiscal 2014 or 2015. So we are bouncing off a trough. We're not quite back to where they were in the fiscal 2014 and 2015 timeframe, but directionally they're moving more positively.

That's our short cycle work as a whole. A sub-segment of our short cycle work is more exciting, which is our aftermarket or spare parts and that is actually up about 20% year-to-date compared to where we were last year and it's flattish compared to fiscal 2014 and 2015 levels. That is all very encouraging.

Joe Mondillo: Would you say over the last six months or nine months on a sequential basis, is that an acceleration from six, nine months ago or was it stronger six months ago and have you started to see any slowdown? Just wondering within the last say 3 months or so, are you seeing any sense of a slowdown given what we're seeing in the global economy?

Jim Lines: I hate to make comments on a quarter-to-quarter sequential basis because it can be misleading. That's why I chose to make the remark based on year-to-date. The three quarters in aggregate compared to three quarters in aggregate a year ago, but on a quarter-to-quarter basis which I'm suggesting was not a great way to look at it, it's up 20% year-on-year, and on a sequential basis it's sort of flattish to up 10%.

Joe Mondillo: Could you talk about the refining business and the chemical business? I know both of them have different fundamentals at times. Could you also discuss what you're seeing within those markets in general? Then, on that geographic perspective, could you address what you're hearing regarding that? I know China is a big market where you own maybe 50% or so market share. What are you seeing in that market, as well as some of your other international markets?

Jim Lines: Sure, Joe. Starting with refining in the international markets, this is for bidding activity. We have a very nice basket of opportunities in Asia and these projects are fairly large, in the $5 million to $10 million value range and there's a few of those. We see a nice basket of opportunities that are coming up in India, in Southeast Asia, and also in China.

China seems to be moving back toward a couple of refining projects a year starting to go ahead. We have those identified. We're working on those early. We're involved in the early work on the India projects and we've been chasing some of the Southeast Asia projects and FEED and EPC bids for a couple of years and they're coming up to fruition now, it seems like. We are feeling more enthusiastic about the outlook in the international markets for refining. This is principally new capacity commentary in the international market. So there's a very sizable amount of work that we've identified, we're participating in and feel generally pretty good about. And the sales organization and engineering teams are doing the right things to get us in a position to have the right participation level, and we believe the right success level for those projects.

In Latin America, that's a slow area for us. There's not much going on there except for a couple of projects that will likely go ahead, but it's nothing like the identification of the project scope that we saw four or five years ago coming in Latin America, but there will be pockets of revamp and replacement to keep certain refineries up and running that have capital to do so.

In the Middle East, we're not seeing anything readily right in front of us. That's more for purchase over the next two or three quarters, but there are some projects that are percolating for new capacity throughout the Middle East that we feel we'll participate in. Again, that's new capacity.

Then in North America, I would say it's steady around revamp, debottleneck, and the aftermarket elements of North America's refining base. We generally feel good about the oil refining outlook both domestically and internationally, taking a longer-term view or a mid-term view over the next couple of years.

Petchem, the next wave in North America is sputtering along. By no measure is it as stout as the first wave. It's going to be measured, and not come in with the strong wave that we saw during the first wave. We've won some of the work. We're bidding some of the other work that's coming up. I think that's going to be more of a periodic type of order environment and a steady flow. And in the international markets, I'd say that's comparatively steady versus the last couple of years for petchem and chem.

Joe Mondillo: I think that was great. Just to clarify, given what we've seen in commodity prices and global economic activity, it doesn't seem like your picture of things has changed a whole lot, compared to three months to five months ago. Is that fair?

Jim Lines: I think that we've kept a balanced look. We've not been overly enthusiastic, but we definitely feel more positive about the near-term outlook. But by no measure do we think it's anything like 2004, 2005 and 2006 yet, but it's not bad.

Joe Mondillo: To follow-up again regarding the same type question. When you look at your bidding and quoting activity, the pipeline there, has that been consistent over the last couple of quarters? Has anything changed recently? Anything to highlight there of interest?

Jim Lines: No. I do have this dialogue rather frequently with the sales and the application engineering group. It feels fairly steady at an okay level. Again, I like to compare and contrast the different periods of time in our history and trying to find that catalyst that's like 2003, 2004, 2005 but we're not quite at that level of activity. We're not at that level of activity but it is moving up from two or three years ago and it's fairly steady.

Joe Mondillo: I wanted to ask a question regarding your backlog in terms of gross margins. How do the gross margins in the backlog compare relative to the gross margins that you've been seeing over the last few quarters. If you take out the second quarter when you saw 29%; that was sort of an outlier. But if you take out that, you've been between 22% and 24%. How would you say the backlog compares to where you've been in terms of gross margins?

Jim Lines: I would say directionally it's upward compared to what's being relieved. We had some recent wins that are pretty sizable wins, where we're going to do a large percentage of the work with international fabricators. That has an effect of changing the dropdown, but as we load up our asset base with work for Batavia, as an example, to manufacture, that incremental volume at a different margin profile drops down to operating profit just fine. It averages up. The booked gross margin might look as though it's averaging down, but at the operating profit line, it averages up.

Joe Mondillo: No, I understand. There's a mix issue especially with Navy starting to ramp up a little bit. I also wanted to ask you on SG&A levels. In the last two years your SG&A has outpaced the growth rates on the revenue line. Looking at fiscal 2020, I'm not sure if you have a good idea at this time, but I know you did make some investments over the last two years specifically in your sales force and elsewhere. Looking at fiscal 2020, do you have any idea how you're thinking about SG&A? If you're able to get the revenue growth that you're alluding to in fiscal 2020? How do you think SG&A plays out?

Jeff Glajch: Hey Joe, this is Jeff. We have seen a pretty meaningful step up in SG&A in fiscal 2019 as you noted. That was due to a number of things. One is, we have added some significant resources particularly in our sales organization and our support organizations to support the level of growth that we're seeing now, but more importantly, the level of growth that we expect to see going forward. Then we've had some low points on commissions and variable compensation and things like that over the last couple of years, which have stepped up in fiscal

2019. While we're not in a position to put anything specific out for fiscal 2020, I would say fiscal 2020 relative to fiscal 2019 will probably be higher, but it shouldn't be the level of step up that we saw from 2018 to 2019 or from 2017 and 2018 and 2019. Hope that's helpful.

Joe Mondillo: Okay. Yeah. Definitely. Last question for me. I just wanted to know that $206,000 in other income, it's been a run rate for the last few quarters. What is that related to exactly?

Jeff Glajch: Sure. There was a change in how the pension accounting was handled. If you think about pension income and pension expense, it was all in the past put together as one number and a portion of that number would be in cost of goods sold and a portion of it would be in SG&A. There's now a piece of the income side that is excluded from that cumulative number and that is now put down in other income. What has happened is, in the SG&A and cost of goods sold, on a quarterly basis, our expense, or lack of income I guess is a better way to put it, is now higher in cost of goods sold and in SG&A.

Then there's that other income line in every quarter. The $206,000 that's in there was that number, will be that number and it should be the exact number or pretty darn close to it for the fourth quarter. I don't know what that number will look like in fiscal 2020 because you have to revalue all your pension information at the end of every fiscal year. So I will know in the middle of April whether that's $206,000 if it's a little bit higher or a little bit lower. I don't think it'll change dramatically, but that number will now stay in other income and that has increased our costs by that same level on a quarterly basis up above the operating income line. Again, it's an accounting change that just kicked in this fiscal year.

Joe Mondillo: Okay, that's good to know. To go back to my prior question regarding SG&A, almost about $800,000 is causing SG&A to ramp up too.

Jeff Glajch: Some of that. There's a little of that in cost of goods sold too but there's a lot of that in SG&A.

Joe Mondillo: Okay, perfect. Thank you for taking my questions.

Jim Lines: Thanks, Joe.

Jeff Glajch: Thank you, Joe.

Operator: Our next question comes from the line of Bill Baldwin with Baldwin Anthony Securities. Please proceed with your question.

Bill Baldwin: Good morning, Jeff and Jim.

Jim Lines: Good morning, Bill.

Jeff Glajch: Good morning, Bill.

Bill Baldwin: What do you think is weighing on the petrochemical business right now, is it slower than perhaps we would have thought a while back? Is it the macro picture, or is it the volatility and feedstock cost prices? Or do you have a sense for what's impacted their CapEx plans?

Jim Lines: I have a view. If we think about the amount of incremental capacity that was added in the first wave, it was massive, on the order of almost 5% of global ethylene capacity was added in the first wave, that's still being digested. The supply and demand effect of how that influences prices of the goods that are being sold, I think, it's a cause for pause, and a more measured pace for Phase 2 of the expansion cycle phase. Phase 2 will be realized.

I think we've always felt and always communicated that Phase 2 would be elongated in comparison to Phase 1, and that was just a massive amount. A step change in North American capacity came in under Phase 1 and which is now starting up, and that has an effect on commodity prices. I think the project sponsors are watching how that's playing out and selecting their point in time to add more capacity.

Bill Baldwin: Are you talking primarily right now about cracker-type activity, Jim? Are you getting more into derivative-type plans?

Jim Lines: I would say that comment pertained to principally the crackers, the ethylene plant. However, the ethylene plant is built for the sole purpose of feeding the downstream derivative plants. Therefore, they tend to go together. We are still seeing some activity of downstream work as it pertains to Phase 1 expansion, but we think that's largely run its course. Again, we're staging for the second wave of expansion and we've won some work or we're seeing some bidding activity. And honestly, Bill, we've been watching this bidding activity for some of these projects for two and three years already. Sponsors just aren't pulling the trigger.

What happens in the Gulf Coast, and I think you know this better than most, is when there is this concentration of new capacity in a tight labor market, skilled trades become scarcely available and the costs go up and that also slows the pace of further incremental capacity, because costs start to get out of control, schedules get elongated and the sponsors just want to wait until things cool off a little bit and there's a more predictable cost and execution schedule. For us, it's normal cycle flow. There's a surge, there's a backing off, there's a more measured pace when things ramp up and get more stable. I think we're in that more stable period, but the skilled trades are affecting cost and are affecting schedules.

Bill Baldwin: That's good color. Appreciate it.

Jim Lines: Oh, you're very welcome. Have a good morning.

Operator: Ladies and gentlemen, we have reached the end of the question-and-answer session and I would like to turn the call back to management for closing remarks.

Jim Lines: Thank you, Dana. And thank you everyone for your time this morning. We're pleased to update you on our third quarter and we look forward to updating you on our year-end results during our fourth quarter conference call and also providing our initial look for fiscal 2020 at that point in time. Have a great day. Thank you.

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