

Operator: : Greetings, and welcome to the Graham Corporation Third Quarter Fiscal Year 2022 Financial Results Conference Call. [Operator instructions] Please note that this conference is being recorded.

I will now turn the conference over to our host, Deborah Pawlowski, Investor Relations for Graham Corporation. Thank you. You may begin.

Deborah Pawlowski: Thank you, Diego, and good afternoon, everyone. We certainly appreciate your time today and your interest in Graham Corporation. Joining me on the call are Dan Thoren, our President and CEO, and Jeff Glajch, our Chief Financial Officer. You should have a copy of the third quarter fiscal 2022 financial results, which just released a few minutes ago. If not, you can access the release as well as the other slides that will accompany our conversation today at our website, grahammanufacturing.com. I also want to point out that we also now have ir.grahamcorp.com to access the investor information.

If you'll turn to Slide 2 in the deck, I will first review the safe harbor statement. You should be aware that we may make some forward-looking statements during the formal discussions as well as during the Q&A session. These statements apply to future events that are subject to risks and uncertainties as well as other factors that could cause actual results to differ materially from what is stated here today. These risks and uncertainties and other factors are provided in the earnings release as well as with other documents filed with the Securities and Exchange Commission. These documents can be found on our website or at sec.gov.

During today's call, we will also discuss some non-GAAP financial measures. We believe these will be 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 reconciliation of non-GAAP measures with comparable GAAP measures in the tables that accompany today's release and the slides for your information.

So, with that, it's my pleasure to turn the call over to Dan to begin. Dan?

Dan Thoren: Thank you, Deb, and good afternoon, everyone. I am starting on Slide 3. As you might imagine, having just assumed the role of CEO in September, reporting this fiscal third quarter's results is a little bit rough. Revenue has increased to \$28.8 million, but we had a loss of \$0.35 per share. The loss was driven by Navy project cost overruns in our Batavia operations as a result of decisions we made during the quarter to ensure timely execution of our high-profile submarine and carrier projects.

The multiple decisions that led to the loss were for long-term gain over short-term pain and were not made lightly. Our Navy business is very important for our future. We had to protect this business and ensure our customers knew we were committed to hitting their need dates, even though we took a significant financial hit in the quarter and over our fiscal year 2022. Jeff and I will provide more detail on subsequent slides.

As a result of the quarter loss, we were out of compliance on our financial covenants, which required suspending our dividend. Jeff will talk more about the waiver we obtained and the coming amendment of our credit facility.

While this was a disappointing quarter and has been a very challenging year, we are deeply committed to our strategy to diversify beyond refining and petrochem with our defense work. The pivot towards defense has been successful, as indicated by bookings and revenue. Our defense revenue is now over half of our total revenue. We had a huge bookings quarter at \$68 million. Over half of these bookings were at Barber-Nichols. Now that we have the bookings, we have to execute this work profitably. The final point on this page is that Barber-Nichols' performance is exceeding our expectations. They are building a larger backlog and delivering strong margins. Jeff will provide more detail in the financial discussion.

But first, I'd like to provide more detail on our Navy challenges in Batavia. We'll move to Slide 4. Let me first address what led up to our third quarter performance. To date, Graham manufacturing has been very successful in winning the trust and confidence of the U.S. Navy and its prime shipbuilders with its high-quality heat exchange and vacuum products used in the nuclear Navy power plants. Navy orders and backlog continue to climb and have now significantly exceeded our commercial backlog and will soon exceed our

commercial revenue. As of December 31, 2021, our Navy backlog in Batavia was over \$100 million. Those orders come with big expectations.

As we have worked over the last 2 years to continue to win new business and meet those expectations, a perfect storm brewed in our third quarter. There were several events that led to our need to readjust in Q3. After getting started on Colombia, there was a Navy-wide reset of quality requirements that caused delays with welder and quality recertification. This was followed by the impact of COVID-19, the ongoing limited skilled workforce in the welding trades and the sheer magnitude of work running through our shop combined with first article learning curve. All of these items caused us to get behind on our Navy jobs.

We do continue to have first article challenges. This is quite typical with defense projects, and we would have expected this on the Columbia project. We've reviewed this with you in the past. Now, while the CVN-80 work is not a true first article job for us, the lack of process documentation from the previous work, combined with severe labor challenges and use of contract welders new to the equipment, caused challenges on the carrier work as well.

Even as we work to catch up on hours, our equipment became the pacing item associated with our nation's most strategic ship and submarine build schedules. The pressure to expedite was extreme.

Let's turn to Slide 5. The chart on Slide 5 shows our labor plan with blue bars, our actual labor application in gray bars, and the resulting deficit of hours caused by actual being less than our planned hourly expenditure. The depth of our deficit occurred around May 2021. In past calls, we talked about redirecting commercial welders to Navy and hiring contract welders to address this deficit. In the third quarter, we redirected even more commercial welders, outsourced more commercial work, hired more contract welders and even added some of our new welders that completed our training programs. These actions helped to reverse the Navy labor deficit, but they came at additional costs.

Outsourcing commercial work results in less margin. We also realized less third quarter revenue as the outsourced suppliers were not able to ramp up quickly. The contract welder costs were high, the specialized training required by the Navy took a long time and retention of the contract welders was poor. Ultimately, we've been able to reduce our Navy program labor deficit by doubling our Navy workforce, mitigating the schedule slips and keeping our customer relationship strong. The deficit should be erased in the first half of fiscal '23, but we expect to start reducing high-cost contract welders as we enter the next fiscal year. In the end, the actions we took to stay on track in the last quarter resulted in revising estimates on labor hours and material, and we booked loss conversion costs that were recorded in the quarter and impacted our results as well. Jeff will cover that detail in the financial briefing.

Certainly, we've learned a lot from this experience and have or will institute corrective and preventative actions to ensure that we continue to grow our Navy business and can deliver quality products in a timely fashion and earn a fair return for our efforts. Our customers have been very appreciative of our efforts, and we do not see any negative consequences if we hold current deliveries. This equipment is built into the bowels of these ships, and they will never come out. Thus, quality is paramount, and Graham has not disappointed.

As we catch up on these programs and reduce our labor deficit, we can reclaim margins by eliminating contract welders, reassigning our commercial welders back to our commercial product and reducing the outsourcing that we're doing today. Our people pipeline continues to be critical, and our welder training program will be continued.

Looking back, we could have done a better job in predicting and mitigating the situation with better developed FP&A, financial planning and analysis, and project management skills. We are adding new talent with defense expertise in Batavia to better manage these processes. In fact, we're adding a new position and Batavia will have a Navy Business Leader beginning February 28.

As we look forward, our processes need to advance to enable our ability to document and optimize all of our fabrication processes to prevent a recurrence of these first article issues that we've seen. We see

opportunities to increase future profits with investment in time-saving automated welding and we're evaluating current contract margins and revisiting pricing on future production opportunities.

In summary, our Batavia defense business was hit by a perfect storm at a very inopportune time. We made decisions to protect our strategic Navy business. It cost us in the short term but proved our dedication to our customers for the long term.

With that, I'll turn it over to Jeff to discuss the financial details, starting on Slide 6.

Jeff Glajch: Thank you, Dan, and good afternoon, everyone. If you could turn to Slide 6, as Dan mentioned, our third quarter performance was quite disappointing. Sales were \$28.8 million, up \$1.6 million over last year's third quarter. Barber-Nichols contributed \$12 million in sales in the quarter, helping to offset the weak sales quarter of our legacy Graham manufacturing business.

Our Batavia operations were impacted because of its need to focus on catching up and executing the two large Navy projects. Those projects will both require more labor and material costs to complete than were projected at the start of the quarter. The additional labor hours to complete the projects impacted the quarter's revenue, since we did not move the projects as far along as expected. The added labor and material costs, including the use of higher cost contract laborers, required us to record increased reserves.

The sum of all these items impacted both revenue and gross margin. The impact of the cost increases and required fully burdened contract costs in the quarter were \$2 million. In addition, the delayed revenue was approximately \$6 million, and the delayed operating profit is approximately \$750,000. Furthermore, to get back on schedule with the Navy projects, we reallocated our commercial labor to Navy work, which resulted in increases in cost estimates for those jobs, which have now been outsourced. All of the above items contributed to an adjusted EBITDA of negative \$2.6 million in the quarter and an adjusted net loss of \$0.27 per share. On the positive front, with the addition of Barber-Nichols, we had 58% of our sales to the defense industry as well as 5%, or \$1.5 million, to the space industry.

If we can move on to Slide 7, the impact of the third quarter results, on top of a challenging first half of the year, have yielded an unacceptable loss even as sales increased 16%, or \$11.3 million, to \$83.1 million. There is a bright light within the results, and this has been the contributions of Barber-Nichols, which we acquired on June 1.

In the seven months since the acquisition, BN has contributed \$31.9 million in sales, offsetting significant declines in refining and petrochemical markets. In fact, our diversification into defense, which is less cyclical than our commercial business, has resulted in 52% of our year-to-date revenue coming from that industry. The shortfall in commercial sales in the first 9 months of the fiscal year reflects the very low order levels, which we saw in the second half of fiscal 2021.

The two Navy projects in our Batavia operations will continue to convert over the next three quarters and we expect this to be behind us by mid fiscal 2023. As of December 31, we recorded all known expected costs on these large projects. We are also implementing expanded processes within our project management group to better review all of Batavia's major projects. The year-to-date impact of increased cost on these two jobs is approximately \$4.5 million. In addition, the delayed revenue was approximately \$12 million, and the delayed operating profit is an additional \$1.5 million. These latter amounts will be recognized over the next three quarters as the jobs are completed.

We've had to outsource more commercial work and have also had cost challenges on a couple of projects. This, too, has impacted financial results. The increased cost of outsourcing and higher costs has impacted the commercial business by \$3 million. All of the above items contributed to an adjusted EBITDA of negative \$5.4 million year-to-date, a year-to-date net loss of \$0.70 a share and an adjusted loss of \$0.60 per share.

Barber-Nichols, again, is a strong positive in the first three quarters. In the seven months since the acquisition, BN sales are on track at \$31.9 million and EBITDA margins are well ahead of expectations. I have noted in previous calls that we were expecting \$45 million to \$48 million in sales and low double-digit EBITDA margins. The sales number is on target, and we are now seeing mid-teen EBITDA. In fact, through

seven months since the acquisition, BN has achieved our targeted EBITDA for the full fiscal year, so its Q4 EBITDA will represent overachievement compared with our expectation.

Moving on to Slide 8, given the weak financial performance in the first three quarters, we have failed to meet our debt covenant related to debt-to-EBITDA and fixed cost charges. This miss was due to the EBITDA loss. We were given a waiver by our lender for Q3 and are proactively in negotiations to amend our existing bank agreement. Because of the covenant misses, it was necessary to suspend our dividend and, as part of the waiver agreement, we have agreed not to utilize more than \$15 million of our revolver.

I want to be clear that the issues we are seeing are P&L profit issues and not liquidity issues. We have sufficient liquidity from the cash we are generating from operations to work through our challenges. In fact, in January alone, we lowered our revolver debt from \$9.75 million to \$6 million and we expect to lower it further between now and the end of March.

Conversations with our lender have been very positive. I've been pleased with the bank's willingness to understand the details and not overreact to the numbers. They understand the near-term challenges are primarily related to profitability and delayed revenue. While there are certainly some significant cash cost increases, the costs booked in Q3 and the elongation of project revenue and profit recognition into future quarters have doubled down the impact on our year-to-date P&L. The bank and I both expect the lending amendment to be completed by the end of Q4.

Onto Slide 9, with some very good news on the order front. As Dan noted, orders in Q3 were \$68 million. Just over half of this came from Barber-Nichols, with most of their orders coming from key defense projects. They also continue to bring in a nice level and variety of space orders. On the commercial side, Graham manufacturing saw another strong quarter of aftermarket and short-cycle orders. Those are promising since, historically, an increase in those areas has often been a precursor to a recovery in capital investment by our customers. We also booked a significant refinery order in China.

Our backlog at the end of Q3 is a record \$272.6 million, with both Barber-Nichols and the legacy Graham business having a nice step-up in their respective backlogs during the quarter. Defense represents 77% of total backlog. This defense backlog extends over the next six years, though much of it converts in the next three to four years.

Additionally, we are seeing growth in our commercial backlog. The commercial backlog was quite low entering the fiscal year. It has grown from \$33 million at the end of March to \$63 million now. About 1/4 of that increase occurred when we added BN; the rest was due to orders received in the first nine months of the year. Another positive feature of the commercial backlog and its growth is that it has a much shorter conversion cycle than the defense backlog, generally 12 to 18 months. We've had a rough fiscal 2022, but the future looks far better.

Moving on to Slide 10, we have lowered our guidance for fiscal 2022. Our revenue guidance is now \$120 million to \$125 million, which implies \$37 million to \$42 million in Q4. We expect a breakeven adjusted EBITDA in Q4. While this is below our prior expectations, it's far better than Q3 results, and we believe we have turned the corner on many of the challenges we have faced this fiscal year.

I will now pass the call back to Dan to talk about our strategy going forward. Dan?

Dan Thoren: Thank you, Jeff. We are now on Slide 11. At a high level, we have been talking about a strategic pivot towards defense for many years and we have been making good progress. The long-term visibility of strategic naval programs provides stability and an ability to invest intelligently in our business, and it offsets the cyclicity and challenges of our refining and petrochemical markets. The acquisition of Barber-Nichols strengthened the strategy and brought additional market experience to our company. As with any new venture, we have had some lessons learned and opportunities to further strengthen our strategy.

I'd now like to give you some insight on how our strategy is evolving going forward. Let's turn to Slide 12. Graham Corporation is a related group of mission-critical engineered product companies that win on superior quality, performance and customer trust. Our corporate role is to strengthen our member companies with best

practices, leader rotation and board expertise while providing value-enhancing services and coordinating collaboration to win large programs.

In fact, we are filling out critical leadership positions and upgrading talent for what the future of Graham Corporation requires. Our Board took on this requirement themselves last year after the BN acquisition and began a search for director candidates with strong defense experience.

Our Batavia operations, which we are referring to as Graham manufacturing, will continue to serve the Navy refining and petrochem markets with high-quality, highly engineered heat transfer and vacuum systems. It is expanding into new energy, and we'll now put more focus on aftermarket opportunities to be a life cycle partner with our customers. Internally, we are restructuring for significant Navy growth, and we'll be leveraging our large installed base for growth capital.

Our strengths will help us realize our goals. In Batavia, we want to realize strong margin in all of our markets, improve our operational effectiveness and develop capabilities to provide more value to our customers. We need to establish roles and responsibilities to align with the structure designed to be responsive, analytical and forward thinking, and we need to create an organization that is accountable and that can diagnose problems, evaluate alternatives, improve, develop, reshape and quickly redirect as required. Importantly, we need to make sure our people are provided the tools, materials and information they need to do their jobs well.

Barber-Nichols continues on its path of intelligent full lifecycle turbomachinery systems in identified high-growth potential markets. BN has structured people, technology and customer relationships mostly in place. They are moving to the next level in teams, processes and improvement to optimize business performance, while working even closer with customers in developing new product to ensure year-over-year growth.

Our future opportunities will be the result of proper execution of our plans that will get us beyond these short-term issues. We believe this is the inflection point. We have no doubt hit bottom, so I am confident we can go up from here. I realize that we have to prove to you that we can drive earnings and generate cash. As Jeff noted, we already have in the first month of 2022.

As we look to our future, we see the BN acquisition as a model that we will look to repeat. There were several novel approaches utilized that we believe can entice the best and the brightest small independent companies to join us.

Let's turn to Slide 13. We are an organization in the midst of dynamic change. We serve great markets. We have the confidence of the customer. We have the orders and the backlog to prove it. We have been challenged on execution but have identified the issues and put corrective actions in place. We have a plan for growth. We believe we have a strong business model with excellent earnings power and cash generation. While we have several quarters of work to get these projects out the door, we are on the upward trend of the curve.

With that, I'd like to turn it over to Diego; and then, Jeff and I will answer questions from the audience.

Operator: [Operator instructions] Our first question comes from Tate Sullivan with Maxim Group.

Tate Sullivan: Dan, starting where you left off, can you give more background on Barber-Nichols? Have you historically grown with acquisitions and is there a pause in that in the acquisition strategy?

Dan Thoren: Barber-Nichols has grown organically over many, many, many years. The last acquisition they made might have been in the '80s, and it was a local machine shop, so it was all organic growth. From about 2002 to present, they have been growing at about 10% per year. As we think about acquisitions going forward, we need to get healthy first. We need to get healthy, build up some cash and then start looking at acquisitions. We believe that there are some really interesting small companies out there that would be interested in joining us, but we're not even thinking about that right now. We're really thinking about getting our performance back into place.

Tate Sullivan: Okay. And on to the U.S. Navy, the developments with Columbia Class and aircraft carrier work out of Batavia. Coupled with the increase in orders from the defense industry, is it fair to say that you fully satisfied the delivery time tables with the Navy? Did they work with you on that, or did they extend them? I mean, how happy of a customer are they?

Dan Thoren: They're actually pretty happy. They understand that we are in a market where we're challenged to bring on welders. They are in the same boat. They are really struggling to keep their workforce moving and growing. And so, they completely understand where we are, but these are strategic programs. There is a lot of pressure to keep these things going and a lot of people that stand around if our equipment isn't there, so, certainly, they have worked with us to rearrange potential work on their side to accommodate any slips on our side. We have to get that stuff to them, so there are very well-defined deadlines for both Colombia and CVN-80 that we are working to. We're very confident that we're going to hit those deliveries and the customer is very happy with the big decisions that we made to try to expedite and mitigate the schedule impact that they might have seen had we not done this.

Operator: Our next question comes from Andrew Shapiro with Lawndale Capital Management.

Andrew Shapiro: I'm kind of new to the story here and I'm just trying to understand what's going on in Batavia to better understand how things, I guess, got out of whack. These programs were bid by Graham and with a certain timeline and then went under contract; and then, things happened that have caused cost overruns, delays, et cetera. Did the workforce vanish? Were there supply difficulties for you? Is it the labor? Where are the problems? I'm just trying to understand how they got out of whack from what was originally bid.

Dan Thoren: Sure. So, a couple of different things happened there. First, on the labor deficit, if you will. It was one of those gradual and then sudden kind of things. If you look at that chart on Page 5, it shows our plan versus our actual. If you look at the quarters, there's not a lot of difference between them, but as you start to stack those up, you get further and further behind. And so, we got to the point in May of 2021 when we hit that bottom.

Certainly, the company was searching hard for additional people to come in. The contracts had a plan. There was a labor plan that basically said we're going to increase labor over time and work on those projects and hit the delivery dates, but, as each quarter went by and we got a little bit more behind, we had to take more and more drastic steps.

The first big step that the company took was, we started to move commercial welders and assemblers over to the Navy side. There was some training that had to happen there. By moving commercial folks over there, we could start to mitigate that slip, if you will, but it wasn't enough. We continued to try to hire but could not hire welders. In fact, our customers were having the same problems that we were. Certainly, COVID and some of the government subsidies to help people stay at home didn't help us for sure.

Then we got into the summer, and it was becoming critical, so we started a weld school, a more formal weld school where we actually paid a company in Rochester to train welders for us. And then, we went out and contracted with companies to bring in contract welders. We had to train those folks and get them up to speed. As we went on into the fall, we continued to struggle to get caught up and we started to have some very high-level Navy visits, where customers came in along with their customer at the Navy, and said, what can we do to expedite this? The knobs that we had were to essentially bring even more commercial welders over to the Navy side and hire even more contract welders.

It was difficult, certainly, to get those folks trained and up to speed. The Navy has some really difficult requirements to make. We actually saw some people that couldn't pass the requirements leave after 3 weeks of us training them and trying to get them qualified, so it was just very, very difficult to bring on welders to execute this.

We have enough, though, at this point that we are turning it around, so you see that deficit curve start to swing back up to the positive. You can see also that our actual labor input into the programs is higher than

planned. So, we're definitely catching up and customers are happy about that and are congratulating us on being able to do that, but that doesn't help me and our stockholders stomach the pain anymore.

Andrew Shapiro: Right. The acquisition of Barber-Nichols and your ascension into heading up the company occurred in what quarter?

Dan Thoren: September 1 was when I became CEO.

Jeff Glajch: The acquisition occurred on June 1.

Andrew Shapiro: Okay, and you're a March fiscal year-end, so that's Q1, Q2 of '22?

Jeff Glajch: Correct. Q1 was the acquisition, and Dan became CEO in the middle of Q2.

Andrew Shapiro: So, by observation, it seems like the acquisition saved this company from all of this. Usually, it's the other way around where acquisitions tank a company, so, I guess, thank you.

Dan Thoren: We feel very fortunate to be able to have that backstop, yes.

Andrew Shapiro: Okay, so regarding this red line on Page 5, the cumulative labor deficit or hourly deficit, when do you feel that you'll have the program caught up? Having the program caught up certainly has correlation in the trend of return to profitability, but while it's correlated, they might be on a different time frame because you've had to accelerate and pretty much recognize a certain portion of the contract, basically, as 0 margin going forward for a certain amount of time because that's what defense accounting requires.

Dan Thoren: Right. We believe that in mid-fiscal year '23, we will be caught up. We actually have more capacity than demand right now, so, whenever we can, we're going to start trimming this high-cost labor out. We want to make sure that we hit our deliveries, but whenever we can start to trim off some of the high-cost contract welders, we're going to do that. As soon as we can start to move our commercial welders out of Navy and back to the commercial side, that allows us to bring some of this outsourced work back inside and also helps our margins, so it will be almost a week-by-week kind of evaluation, how we track in and how we start to reduce some of those high-cost components of our business and start to build back our margins.

Operator: Our next question comes from Theodore O'Neill with Litchfield Research.

Theodore O'Neill: I'm sorry about the results and I certainly understand what you had to do to keep the business moving, but what I wanted to know is, over the last year, the firm has made a pretty big effort at telling us about how they have a welding school program and that it's working well for you. And so, I was wondering, do you make changes to that program, or can you not find enough people? Can you give us some more granularity on your internal welding correspondence school?

Dan Thoren: So, there's a couple of welding schools. Graham has a welding school internally that's not as formal. It takes existing welders that already are trained in the skill set and then teaches them the Graham specifics. Since we couldn't find welders that already had experience, we went into more of a let's-start-from-scratch approach, and that was done with a trade school in Rochester, New York. That, essentially, takes people that do not have welding skills and it teaches them welding from the ground up. We were really happy with how that went. Our first class started, I think, in July and it ended at the end of November, and we had our welders, our managing type folks, going to the school, checking on the progress and kind of watching the students as they went through. We started with 10, I believe, and we graduated 8 in November. Some of those graduates, I think, started in December, but most of them started in January, actually on the floor. So, they came back here and learned the Graham way of how you do it, how you track it, how you document, et cetera; and then, they were able to go to the floor and start producing for us. We were extremely happy with that program, and our next class starts in February, in the next couple of weeks, I believe. Again, we'll probably have a class of 10, which is the limit of what they can put through there. It won't be a huge class, but anything helps, so we're really kind of excited about that.

Theodore O'Neill: And so, that's going to be the ongoing way that you bring welders in?

Dan Thoren: Yes.

Operator: Our next question comes from Chris MacDonald with Kennedy Capital.

Chris MacDonald: Dan, could you elaborate on some of the new hires in the defense business from a management perspective, please?

Dan Thoren: Yes. So, as Graham has kind of been stuck in this downturn on the energy side for many, many years, it has been a struggle organizationally to keep profitability and our workforce up as we've had to go through different types of layoffs. We ended up laying off, not so much the direct charge welders, assemblers and stuff, but probably more of the middle management types of folks. We also had some retirements that we did not replace. So, we kind of wiped out our middle management, unfortunately, as we've suffered through this energy downturn.

As the Navy has started to grow on the revenue side and the organizational side, we've started to bring in managers from the outside that have some more of this Navy background. The latest one that we ended up bringing in starts on February 28 and is an engineered background that has gone through some of the industry's best operational type programs. He has been running plants as a general manager type in both commercial and defense. He's going to join us at the very end of February will be our leader on the defense side. So, as we've grown this Navy business, we've kind of been having to build the organization as we go, hiring supervisors, managers and now a business leader.

Essentially, we unload our General Manager of Batavia and get him out of the day-to-day Navy business and have somebody that is responsible for that business going forward. Just to give you a sense of other folks, we hired a director of sales on the commercial side. We also had a press release that came out in November that announced that Jeff was going to step aside and retire, so we've been working awfully hard in trying to find his successor. We're awfully busy trying to fill our organizational leadership holes right now.

Chris MacDonald: Okay. Could you just repeat where Barber-Nichols is from an annual revenue run rate and EBITDA margin perspective?

Jeff Glajch: Sure, Chris. This is Jeff. Our guidance for Barber Nichols for the year is \$45 million to \$48 million, which we're on track for. Through the 7 months of ownership, revenue was \$31.9 million and the EBITDA is mid-teens. We had targeted for the fiscal year to be at \$5.2 million of EBITDA on that \$45 million to \$48 million of revenue and we're actually at that \$5.2 million of EBITDA already on the basically \$32 million of revenue through 7 months. We're quite excited about where they are at this point. As I mentioned in my earlier remarks, whatever EBITDA they achieved in the fourth quarter will be in excess of what our expectation was for the fiscal year.

Chris MacDonald: Okay. Great. And the \$45 million to \$48 million is obviously just for the 10 months of the fiscal year when the business was owned by Graham, correct?

Jeff Glajch: Exactly. During the 2 months that we didn't own them, they had approximately \$10 million of revenue, so if you annualize that, you'd be somewhere in the mid- to upper 50s, but it was just for the 10 months.

Chris MacDonald: Okay. Great. And then, Jeff, I think you mentioned \$4.5 million forward loss on the Navy business and then a collateral \$3 million EBIT headwind on the commercial business. Just help me square that up, so the business has lost a little more than \$5 million EBITDA year-to-date. That represents, call it, \$7.5 million, Barber-Nichols is contributing \$5 million. So, is the commercial just with the cycles, is the commercial business just decidedly unprofitable at these levels or am I missing something here?

Jeff Glajch: The other issue is there's some delayed operating profit related to the Navy, because the projects are taking a little longer to complete. That was another \$1.5 million or so. But, to your underlying question, yes, the commercial business is at a low revenue level in the first 9 months of this year. We had really, really low levels of orders in the second half of last year, which drove our backlog down. We knew that

this was going to be a really challenging year for our commercial business. The expectation was that the Navy would cover some of that. Obviously, that has not been the case.

But the commercial business has started to pick up. We've had a couple of orders in Asia right now, in India specifically, that are executing that will help us through this top line standpoint for the fourth quarter and then into fiscal 2023. The aftermarket has absolutely been picking up and that's certainly going to help us going forward, but, hopefully, we'll see a recovery in the commercial capital markets. We've not seen that yet. But to your underlying question, yes, the commercial business is in a rough spot coming into the year and we knew that.

Chris MacDonald: How do you feel about the gross margins in the backlog today? I would think the mix is meaningfully aftermarket and that ought to be a good thing.

Jeff Glajch: Sure. The gross margins in the aftermarket are good in the backlog and we're continuing to see come through orders. The gross margins and the capital projects are perhaps a little better than what's coming out, but they're not by any means at a strong level if you're looking at the commercial business.

And then, with the Navy, as we work through the execution challenges that Dan has talked about and look to the future vessels that we have in backlog already, we expect significantly better gross margins there for 2 reasons. One, the pricing is better on these subsequent vessels, but also, very importantly, as we get through some of the operations and execution challenges, we believe we will be able to execute those better than the current vessels are being executed.

Operator: Our next question comes from Dick Ryan with Colliers.

Dick Ryan: Dan, I think you mentioned project management skills and processes needed to advance. That seems more than just not having enough welders. What might be more fundamental to the story, and maybe I'm reading that wrong, but it sounds like some of the hires can maybe fill in some of those gaps, but we've been delivering against the Navy for quite a period of time. Where did these deficiencies come from and are there any other issues that need to be dealt with other than just adding some more staffing there?

Dan Thoren: Graham is essentially pivoting from an engineer-to-order commercial business to more of a repeat manufacturer Navy business and it's a dramatically different skill set, with dramatically different, essentially, margins of error. If you miss on a small commercial job, it's not a big deal. If you miss on a very large Navy job, it can come back to bite you. And so, just a whole lot more attention, too.

In a repeat manufacturing business, you're really looking at each of your processes and really trying to drive simplicity in, drive costs out and drive efficiency in. You don't do that in a commercial engineer-to-order, everything is a snowflake kind of thing.

If you just think about systems and processes and people, this is a whole different approach, and, honestly, I saw the same thing at Barber-Nichols. When we grew up as a prototype custom turbomachinery kind of a place and then moved into that production Navy, we went through the same kind of learning curve challenges that Graham is going through right now. If you haven't seen it, it's hard to see it, but I've seen it at Barber-Nichols, and, when I come in here and look at it, I say, well, we're not quite there on the Graham side. We have systems and processes and people and approaches that we really need to start to build for the repeat production associated with the Navy.

Dick Ryan: Okay. Jeff, any fees so far on getting the waivers altered and what might we expect with the new lending agreement?

Jeff Glajch: On the fee side, the Bank of America has identified a fee of \$250,000 for the waiver; however, they've only charged us \$25,000 upfront. The other \$225,000 has been pushed to the end of the agreement, which is a number of years out, so our actual upfront cash cost was relatively small, which we were certainly very thankful for.

With regard to the amendment. We've been in discussions for a number of weeks around the process around the amendment and, quite honestly, once we finish up this call and our earnings release, we're going to start

working wholeheartedly toward getting the amendment in place. Our expectation, my expectations and the bank's expectations are that we will have an amendment in place by the end of March. The bank has been very, very open and very reasonable with us. As I noted in my remarks and as we've talked through issues, they haven't taken a shortcut and said, okay, I got that, move on. They wanted to understand the depth of the business and understand what we can and cannot affect. I think they've, quite frankly, from my perspective, treated us very, very fairly, and I expect they will do so in the amendment process also.

Dick Ryan: Jeff, Dan said something about the first quarter or the first month of '22, the profit profile improved. I must have missed that in the commentary. Can you run that one by me again?

Jeff Glajch: Certainly. I think I did mention it, but no worries here. At the end of December, we had \$9.75 million outstanding on our revolver with our lender and we were able to reduce that from \$9.75 million down to \$6 million by the end of January. My expectation is that, through the next 2 months of this quarter, we should be able to reduce it further.

That was really getting at our position, my position certainly, that this is not a liquidity issue. This is simply more of a book P&L issue and, obviously, that drives a lot of the covenants, but that we are not in a liquidity crunch at all. We're actually at a very good situation from liquidity that we're able to lower our revolver usage.

Operator: Our next question comes from Brett Kearney with Gabelli Funds.

Brett Kearney: Jeff, I know it's very much live taking place now, but regarding the dividend suspension, is the thinking at this point that there'll probably need to be a runway period where you get back in line with some form of amended covenants before we see that reinstated? Just generally, any thoughts on that front?

Jeff Glajch: Brett, at this point, the dividend was suspended for this quarter. Once the amendment is in place and the Board has an opportunity to discuss this further, they'll determine a future course. I can't comment at this point on any timing of any kind of a dividend. I would suggest that we need to really look at what the business cash flows look like over the next number of quarters and whether or not any kind of a dividend makes sense and, if it does, at what level. No decision there. Dan, do you want to add some more to that?

Dan Thoren: Yes. The Board has been considering a different approach to dividends. As we look forward and think about building cash for the next acquisition, they wanted management to present to them an analysis of capital allocation priorities; and then, they would make a decision there. But gosh, we're not there right now. We have to get back into covenants with our bank; and then, we can start to have those conversations.

Brett Kearney: Yes. Understood. And then, Dan, just one last quick one. We hear from plenty of companies about the challenging operating environment out there. From the results, it seems Barber-Nichols continues to execute very well. I'm just curious how Matt and the team there are dealing with any labor constraints on that front. How are they managing through this current operating environment?

Dan Thoren: They're actually doing fairly well, and I would attribute that to a couple of different things. One is that people are very willing to move to Colorado. The second is that Barber-Nichols has built an exciting business looking forward. They're very vocal about the exciting things that are going on, so when they're interviewing folks, they're actually getting kind of their top candidates. It is a really tough environment out there, but the BN group has done a great job of building up a culture and a business and excitement that gets people engaged, so they're actually doing pretty well.

Operator: Our next question comes from **Tom Spiro:** with Spiro Capital.

Tom Spiro: Dan, for you, please. Focusing on Graham's naval business, you obviously are under extreme pressure to meet your deadlines. You're responding with contract labor, contract welders and newly trained welders. All of that makes me concerned that 2, 3, 4 years from now, we'll learn that there are a lot of failures and defects that only emerge then. What are your thoughts about that and how do you guard against it? You've told us this is really mission-critical equipment for the Navy.

Dan Thoren: Yes, it absolutely is, Tom, and it's a great question. One of the things that the Navy does really, really well is nondestructive examination, so lots of welding, lots of penetrate inspection of the welds, x-ray of the welds, et cetera, so we have both customers and defense contract management agency type people that are looking over our processes. We get people qualified to these processes and they're evaluated on a regular basis. Each of the work steps are evaluated with a nondestructive examination kind of approach, with lots of eyes looking at these things, so I think the risk of any quality issues is actually very small.

Certainly, we're not as efficient as we have new welders and contract welders working on these things, so I absolutely believe that we're not being efficient with our money at this point. On the quality side, though, I'm not concerned just because of the oversight and all the inspections that happen.

Tom Spiro: That's helpful. My last question would be on the process that Graham has been using to bid new work, the Navy work and also the commercial work, but I guess I'm focusing particularly on the Navy work. Dan, have you had an opportunity to review that process, the old Graham process? Are you comfortable with it? Are you changing it? The right people, the wrong people, new tools? What's your thinking there?

Dan Thoren: For Navy business development and new business, especially now that we've been through a lot of the first article things, a lot of that process is a certified cost and pricing kind of an approach that is based on the time that you actually spent on the last time that you built this stuff. It's pretty cut and dry. You go off and get quotes on the raw material and the different outside services. If you're bringing in outside machining for some very specialty machining or some quality types of things, you're going up and getting those quotes. But it's really pretty cut and dry, relatively low risk, especially in a sole-source certified cost and pricing environment. If we're doing this right, we should be getting better on each one that we make, so we actually should be building margin on new contracts that were based on old contract, labor and cost. It's pretty straightforward. I'm not too worried about it.

Operator: Our next question comes from Chris MacDonald with Kennedy Capital.

Chris MacDonald: Just a couple of quick follow-ups here. One, for the Navy programs with the forward losses, are those all delivered by September? I think you talked about halfway through fiscal '23 being the turning point here, so are those largely done at that point?

Jeff Glajch: Yes, Chris, they are. There's one that may have a little bit of Q3 revenue, but we're talking a couple of hundred thousand dollars, but they're basically done by midyear of next year.

Chris MacDonald: Okay, and what was the forward loss recognized in the quarter? I know you gave it year-to-date, Jeff, but I just didn't pick it up in the quarter.

Jeff Glajch: Forward loss on -- I'm sorry -- the \$4.5 million that I did year-to-date? I just want to make sure I'm answering the right question.

Chris MacDonald: Yes. I wanted to know what you recognized in the quarter relative to the \$2.6 million EBITDA loss at the total company level. How much did you increase the forward loss by on those programs this quarter?

Jeff Glajch: Got it. About \$1 million.

Chris MacDonald: About \$1 million of increased forward loss in the quarter.

Jeff Glajch: Exactly. Yes.

Chris MacDonald: So, you had to recognize a fair amount of pressure on those commercial programs this quarter, which was quite impactful to the P&L, it sounds like.

Jeff Glajch: Correct.

Chris MacDonald: Okay, and you consider that a largely nonrecurring job. I think the thought process was breakeven next quarter, which you get a big part of the way there just by sticking to your plan on defense. Is there anything unique about the recovery plan on the commercial side?

Jeff Glajch: No, the recovery on the commercial side, realistically, probably happens on future jobs as we're getting our direct labor back to the commercial side of the business, those that have been transitioned over to Navy. I think once we get past this quarter, going into fiscal '23, from a labor allocation standpoint, we should be in a pretty good place. Perhaps, 1 of the 2 major jobs has a big shipment in May, so it might bleed a little bit into the first quarter, but, certainly, when that ships in May, then we're done.

Chris MacDonald: Okay. Dan, I would think, just based on what I've heard, ideally, you won't have increased forward losses. You'll have the next production lots on the defense side coming in at profitable levels. If the plan is executed effectively, would you expect to see a number of quarters with sequential profitability improvement in the business? Is that what the plan would yield?

Dan Thoren: Yes.

Operator: Ladies and gentlemen, that's all the time we have for questions. I will now turn the floor back to Dan Thoren for closing remarks.

Dan Thoren: Thank you, Diego. Again, this was a rough quarter, but I see great promise in what we are creating by bringing the Graham manufacturing business together with Barber-Nichols. We're going to leverage the talent across the organizations. We're going to implement better business processes and training that can elevate the potential of both. And we'll build on new capabilities, both organically and ultimately with more acquisitions. Thank you so much for your time today.

Operator: Thank you. That concludes today's conference. All parties may disconnect. Have a great day.