

Deborah Pawlowski, *Investor Relations*

Thank you and good morning, everyone. We certainly appreciate your time today and your interest in Graham Corporation. Joining me here today are Dan Thoren, our President and CEO; and Chris Thome, our Chief Financial Officer.

You should have a copy of the first quarter fiscal year 2023 financial results, which we released this morning before the market. You should also have a separate orders announcement that we released simultaneously. If you do not have these releases, you can find them on our website at grahamcorp.com. Chris and Dan will be doing a formal presentation, after which we will open the lines for Q&A.

If you'll turn to **Slide 2** in the deck, I'll 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, ir.grahamcorp.com or at sec.gov.

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

So, with that, if you would please advance to **Slide 3**, I'll turn the call over to Dan to begin. Dan?

Daniel Thoren, *President and Chief Executive Officer*

Thank you, Debbie, and good morning, everyone. Thanks for joining us today for our first quarter fiscal 2023 earnings call. Just last month, Chris and I presented our fiscal year 2022 results and multiyear strategic plan. I'm really pleased to report that our first quarter fiscal '23 results clearly demonstrate the solid execution of our plan and reinforces our confidence in our expectations for the year.

The strategic plan is in place, goals for fiscal '23 and beyond are set, our teams are engaged, and we are planning, predicting, and actively managing our business. As we progress, we have also improved customer relationships and are strengthening the culture internally with higher expectations as a new enterprise with a solid outlook.

We had strong growth in all markets in the quarter and benefited from a full quarter of our Barber-Nichols acquisition. Also, higher volume of commercial aftermarket work in Batavia contributed to the increase in sales. Importantly, we shipped critical product to the Navy and are back on schedule. We also saw better results that came from improved execution and better mix. As a result, we turned a nice profit in the quarter despite a difficult operating environment.

Ultimately, our first quarter performance gives us higher confidence that we can deliver our guidance. Bookings for the quarter were spread across all of our markets, further demonstrating the success we are having with the transformation of Graham. We have a nice vacuum distillation unit order for a refinery in India; strong aftermarket order volume from energy and petrochem; a small but meaningful set of defense orders, and several space orders to key space industry players that added up to \$7.3 million of new business.

With that, I will hand it over to Chris now to cover in greater detail our much-improved performance in our first quarter results.

Christopher Thome, *Vice President - Finance, Chief Financial Officer, and Chief Accounting Officer*

Thank you, Dan and good morning everyone. If you turn to **Slide 4**, you can see our first quarter fiscal '23 performance, which shows impressive year-over-year growth. Sales were \$36.1 million, up \$15.9 million over last year's first quarter and was across all of our diversified markets. During the quarter, Barber-Nichols contributed an incremental \$8.9 million in sales, augmented by stronger sales from our Batavia operations. More specifically, during the quarter, 27% of our sales were to the defense industry as we delivered 2 First Article projects to the U.S. Navy, one for a submarine program and the other for a CVN-carrier program.

As further evidence of our broadening end-market sales efforts, 18% of sales during the quarter were from the space industry compared to just 4% last year. In our Batavia operations, we had higher sales to the refining, chemical and petrochemical markets, which was driven by aftermarket sales, which were up 38% during the quarter. Our gross margin for the quarter was a healthy 19% compared to 5% for last year's quarter. Improved execution on completed

contracts and a better mix of higher-margin projects contributed to our significantly improved gross margin on both a year-over-year and sequential basis.

SG&A expenses in the first quarter of fiscal '23 were \$5.8 million, up \$836,000 over the prior year, but lower by \$502,000 from the sequential fourth quarter. Having a full quarter of Barber-Nichols in the current period contributed an incremental \$1.4 million of SG&A expenses. This was partially offset by cost discipline and expense deferral initiatives. We have been very intentional in our spending to delay what we can and are leveraging our existing infrastructure to drive improved profitability.

As a result of all these factors, our net income in the quarter was \$676,000 or \$0.06 per diluted share. On a non-GAAP basis, which excludes intangible amortization, acquisition costs, and other unusual and nonrecurring expenses, adjusted diluted EPS was \$0.12 per share. Similarly, we had a very nice turnaround in adjusted EBITDA from a loss of \$2.9 million in the year-ago period to a gain of \$2.7 million or 7.6% of sales in the current period.

Slide 5 provides our capital structure at the end of the quarter as well as our operating and free cash flow results. Graham has always generated good cash flow and is expected to do so in the future. Positive cash net income during the quarter was offset by a working capital build driven by our growth. Typically, the first quarter of the year is the worst cash flow quarter due to the payment of prior year incentive compensation, and that was true again this year.

Additionally, \$300,000 of cash was used for capital expenditures and \$500,000 was used to pay down debt. The net result is that cash decreased by \$1.8 million during the quarter. Availability under our line of credit and future cash flow from operations is expected to be sufficient to fund ongoing capital expenditures and debt repayment. Full year capital expenditures are expected to be between \$4.5 million and \$5.5 million and is primarily relegated for various growth initiatives. Our recently revised lending agreement has provided more financial flexibility as we move into our growth phase, and I am pleased to report that we are in compliance with all of our debt covenants.

On **Slide 6**, you can see the strength and breadth of our orders across all markets. Even with our higher sales during the quarter, increased demand resulted in a healthy book-to-bill ratio of 1.12. Stronger orders continue for our commercial aftermarket, and we have now seen our global expansion efforts bear fruit as we booked a large refining vacuum distillation order in India. Defense & Space orders were across multiple programs and with a variety of key strategic customers. This demand is being driven by our advanced technology and engineering know-how as well as our strong execution. This order diversification solidifies our confidence in our longer-term outlook and growth opportunities.

Turning to **Slide 7**. Our backlog remains at a very healthy level and increased 2% sequentially. Defense remains the key to our backlog story and comprised 74% of our backlog at the end of the quarter. Also notable is that our commercial backlog has increased 42% on a year-over-year basis and 9% sequentially, primarily driven by space and the commercial aftermarket. We believe 40% to 50% of our backlog will convert within the next 12 months and provide stability to our business.

Slide 8 shows our guidance for fiscal '23. Our strong first quarter performance and backlog gives us confidence in our full year guidance. As such, we are reaffirming our expectations of revenue and adjusted EBITDA growth. Revenue is expected to be between \$135 million to \$150 million, which suggests top line growth of about 16% at the midpoint of guidance.

Our confidence in our profitability profile has improved as a result of the strong execution we demonstrated in the first quarter. Nonetheless, we are holding our adjusted EBITDA guidance of \$6.5 million to \$9.5 million. We do believe our second quarter will not benefit as well as the first quarter on mix and deferred expenses, but the second half should normalize to achieve our guidance. As we look longer term, we expect our strategic initiatives to yield high single-digit revenue growth and low double-digit mid-teens EBITDA margins.

With that, operator, please open the phone lines, and Dan and I will be happy to answer investor questions.

QUESTION AND ANSWER

Theodore O'Neill, Litchfield Hills Research

Congratulations on the good quarter. My first question is about this change order for the CVN-carrier program. Is that the sort of thing that's likely to have an impact on the gross profit margin? Or is that something that's completely paid for?

Chris Thome: So, it definitely had an impact for the first quarter on our margins and will continue to impact it. Basically, when customers ask us to make various changes to our contracts, this is with all our customers, we track those changes and then build them accordingly as they were not considered in the original proposals.

Theodore O'Neill: With the growth in the space orders, I see it is not a big dollar number, but where is that growth coming from? Do you have more customers, or are the customers you have doing more with you?

Dan Thoren: Yes, it's both, Theo. We are seeing some follow-on orders from existing customers, and we are continuing to add new customers and developing new products for new customers. So, it's broader and deeper.

John Deysher, Portfolio Manager, The Pinnacle Value Fund

Solid quarter. I was just curious on the CapEx guidance of \$4.5 million to \$5.5 million. That seems to add. I was wondering what specific growth initiatives are you referring to with regard to CapEx?

Chris Thome: Sure. So, I will say that nearly all of our planned CapEx for the year is related to growth initiatives. In particular, with the growth in our defense business at Barber-Nichols, we're looking into potentially moving into some additional space, which is going to require some capital as well as machinery and equipment for contracts that we have in place. We're also looking at some cost savings machinery and equipment at the Batavia operations to improve our efficiency. So yes, it is projects like that.

John Deysher: At both Batavia and Denver?

Chris Thome: Yes.

Dan Thoren: Yes.

John Deysher: Okay. And how does that unfold over the coming 3 quarters? I think there was only \$300,000 or so in the first quarter. Does it unfold evenly through the remainder of the year per quarter?

Chris Thome: Certainly, we're going to see an uptick since we, as you mentioned, we only had \$300,000 in the current quarter. These things tend to be lumpy, but I would say they will be rather smooth over the next 3 quarters. It is kind of hard to judge. It all depends when the execution and when the invoices come in.

Dan Thoren: I would suspect that it builds throughout the rest of the year as we get things in order, the new equipment comes in and the building modifications happen, I think it will build through the rest of the year.

John Deysher: The other question is, you referenced customer change orders. That can be an issue. Are you always able to bill the customer for the amount of the change? Or is that sometimes negotiated?

Dan Thoren: Yes, it is often negotiated because the contracts are never entirely clear, so there is interpretation of what was required and what was not required. So, for sure, they're often negotiated.

John Deysher: So far, that has not been an issue?

Dan Thoren: No, I think that our customers are actually very cognizant of the things that are happening in the market right now with the cost of materials going up, with delays in the supply chain, things like that, our customers are actually pretty accommodating and understand what we are going through because they are going through the same thing.

Graham Madison, Water Hour Research

Congratulations on the quarter. You are seeing some nice pickup in the commercial aftermarket. What is your outlook on that going out through the rest of the year? Will that continue to remain a strong market for you?

Dan Thoren: You are exactly right. It has really picked up. It is very strong right now. In the past at Graham, when that aftermarket started to pick up, it basically predicted that there is future capital spending coming. We are not sure exactly when the capital expenditure will be coming and how strong it will be. For right now, we are very happy with the aftermarket business that is coming in. It is coming in at a rate that is higher than what we have seen in the past. Obviously, aftermarket business is highly profitable for us, so we are actually happy to have that coming in.

Graham Madison: On the improving EBITDA margins you have forecasted, what gets you to that higher margin? Is it volume, a different mix, or just additional operating actions that you are putting into place?

Dan Thoren: Yes. It's all of the above. We went through a rough 2022 with some with some challenging projects. As we push those out, we have delivered a couple of first articles in the last month. As we push out those lower-margin jobs, the bulk of the business that we have in our backlog is better priced. In addition, we are doing quite a bit of work, as we talked about in our strategic plan, on improving our operations and improving the efficiency of the work that is going through.

I would say that it is some combination of price, certainly a contribution from efficiency improvements. They are starting to get some volume too, and the factory is full. We are cranking along. All things are moving in the right direction, which says that our EBITDA margin will start to improve from where it has been.

Gary Schwab, President, Valley Forge Capital

Just repeat, good quarter. Can you expand on what you wrote here about improved profitability being a result of the deliberate decisions you are making as a team to defer cost, manage project timing to improve mix, and take price being earned?

Chris Thome: Dan and I spent a lot of time with the team here, and they have done a great job of putting in financial discipline and deferring costs where it makes sense, really thinking twice before making expenditures. One example is that we did lessen our reliance on some of our third-party distributors last year which is benefiting us this year as we go direct to some of our customers. That has cost savings, as we have noted previously. Additionally, we did see some benefit on price as we went back to our customers on various change orders or with cost escalations.

Thirdly, we did benefit in the quarter from a good mix in the revenue that we are realizing. Some of the challenges with supply chain and material receipts, some of the orders we are expecting in the first quarter did not come out, but the management team did a great job pivoting and moving to other orders, which delivered higher profitability. That is why we are also saying we think we are not going to get the same benefit in the second quarter, but it should normalize in the second half of the year.

Gary Schwab: Going back to the change order, you said you are negotiating these; are you allowed to keep your prior margins on that negotiation?

Chris Thome: The change orders are specific to a customer request, right? The original contract is intact. But then if a customer asks us to expedite delivery or make a change to the original design that costs us something, then we pass along that charge. We do that for all our customers.

Dan Thoren: Commercial and Navy.

Gary Schwab: Now that you delivered your 2 condensers, the one for the Columbia and the one for the CVN-carrier, I assume you are already working now on the next Colombia, the next carrier condensers. Can you talk about what you learned from that first fabrication and where you are seeing the savings on these second articles?

Dan Thoren: Yes, on any First Article, you are not quite sure what all material is needed to begin with. So, as you build it, you find different things that you need from tooling to extra material to different fixtures and machinery. Getting the complete bill of material locked down after you are through the first build enables you to predict the future, so bill of materials is the first piece of it. As you build it for the first time, you can make some mistakes in how you build it. You learn from those mistakes.

The most important thing is to document how you want to build it the next time, which we have been doing. The next time you are basically not going to make those same mistakes. You will know exactly the sequence that you want to build the units; then the folks who have built it know how they did it last time, and it is documented so that they are further down the learning curve.

Certainly, as you sit there and build it, get manufacturing engineering out there on the floor, watch how things are going, think about alternate ways to do that and then try different fabrication techniques on that First Article, these are all things

that we've been able to do, especially on the Navy side with our new Operations Director. We are beefing up our manufacturing, engineering, and the documentation of our build process; we expect to benefit from those actions in subsequent builds.

Gary Schwab: Is this a primary factor on why you expect the second half to be so much better?

Dan Thoren: Yes. It is kind of all of those things. It is better pricing on subsequent units. It is all of those lessons learned and process improvements that we are making for sure. So, all of those.

Chris Thome: Additionally if I could just add to that. As you recall last year, we had to subcontract out a lot of our commercial jobs in order to meet the deadlines that we wanted to meet with the Navy jobs well. That reliance on subcontractors is decreasing. In turn, that makes the jobs more profitable when we are doing them in-house versus subcontracting them out.

Andrew Shapiro, Lawndale Capital Management

This is somewhat of a follow-up to the prior question so I can better understand the differentiation between First Article and beyond. On the First Article components, you are doing a lot of trial in air, et cetera. Were these costs plus or they were off of a fixed contract and a fixed charge initially and then subsequent articles or subsequent components; are separately negotiated or they have already been pre-negotiated as to price?

Dan Thoren: Yes. All of our orders at this point with the Navy are firm fixed price. Essentially, we have three units on one order, four units on another that are all at that price. Subsequent orders, some of which we have in-house, are at different prices. As we got into the first order, we learned where we needed to be. We had the cost that supported a higher sales price, so those subsequent contracts are negotiated at higher price.

When we talk about better pricing, that is essentially what happened. We learned from the First Article, the first contract, and then built-in better pricing into the second and subsequent contracts. So, at the same time, what happens as you go further down the learning curve, you get better and better at building these. Your margins start to improve; it is a combination of better pricing and better margins due to the learning curve.

Andrew Shapiro: So, to understand what is inside of the First Article, because you referred to it as the First Article of the first contract. Is the First Article and first contract for a single sub? Or the First Article and first contract was for a few subs?

Dan Thoren: Yes. I cannot get too specific there, but often, our contracts are for multiple units.

Andrew Shapiro: You have a second contract already in the backlog for, we will call it, the subsequent set of ships?

Dan Thoren: In some cases, yes. We are building a bunch of different types of heat exchangers. In some cases, we have two and three subsequent contracts. In some cases, we have one. In some cases, we are in the process of bidding the next one.

Andrew Shapiro: In a single boat because Congress authorizes only so many of these a year, because they're not cheap.

Dan Thoren: Right.

Andrew Shapiro: In a single boat, are you building one component? Can you comment on how many of these components are in a single boat?

Dan Thoren: Yes, there's a lot of heat exchangers in the boats. We are, in most cases, building multiple heat exchangers per boat.

Andrew Shapiro: How many heat exchangers does it take for you to get up this whole learning curve in terms of efficiencies and productivity as well as efficiencies in pricing?

Dan Thoren: Well, the two big ones we are through. So, we had two big condenser shipments that we just made. We have gotten through the learning curve with those. We have started to incorporate a lot of those lessons learned, and so future margins will improve. Now we will continue to bid additional heat exchangers that we have not built before. They will be smaller and so lower risk for sure. But one of the things that we want to do is expand our Navy business, and that does mean going after new product. So, we will be going through learning curves on new orders in the future.

That said, the more that we get in production, the smaller and smaller impact these first articles will be. Once you build the first article then you build a moat around your business.

Chris Thome: Just to add to that, the First Article is always going to be your least efficient, right? Because the bill of materials is not set. I would say the efficiency gain off the first is going to be the greatest, and then it will diminish after that. We will still continue to try to improve our processes. But the biggest one with the first is getting that bill of materials locked down, and that will not change after we do the first one.

Andrew Shapiro: And in the backlog, does that include contracts that were arguably second articles, but before you learned all this on the First Article?

Dan Thoren: You are on the right track. Each one that we build will be better and better. Some of these are at the lower pricing, but the margins will improve just because of the lessons learned. So, you think about this business as improving margins over the long term. And that is absolutely what is going to happen as we improve operations, and we get better prices in the future.

Brett Kearney, GAMCO Investors, Inc.

Congrats on the early traction from all the hard work you have been doing. I had a question given the really robust outlook, certainly at Barber-Nichols, and then also we are seeing it on the aftermarket side at Graham and their Navy business. There is some talk from other players, in the energy space and in even larger pump suppliers in that space, that we could see that multiyear CapEx up cycle coming to fruition.

Just curious, as you think about the potential timeline with that, how you all are viewing resources you have to meet the growth ramps potentially in both sides of the business? I know you have done a lot of work at Graham in this area and have already have some great processes in place at Barber-Nichols, but just how you are thinking about resourcing the growth ramp of the business?

Chris Thome: The strong aftermarket growth is certainly encouraging that we are on the cusp of a capital investment cycle here. We are still thinking that it is about 12 months away. Just like everyone else, we are facing labor constraints, and the labor market is definitely very competitive these days. We have been fairly optimistic about it right now. On the Batavia side, we have been reaching out to all the trade schools and colleges, and those programs are full now. Our Arc & Flame program that we sponsor has just graduated four, and we have another 11 that are signed up. They will graduate in November.

We have about 18 welders right now who are in our in-training program. Some will come online in the near future here, but then some will come a little bit longer out. We are pleasantly surprised to see the labor market soften a little bit, and we have started getting some applications from experienced welders. So, we have been doing a great job; the team has been doing a great job by reaching out and getting some experienced hires as well. But just like everyone else, finding skilled labor remains a challenge, but we are working on that every day.

Dan Thoren: On the facility side, we still have quite a bit of room to grow and expand in Batavia. Barber-Nichols is more constrained, but we are very active looking at areas where we can expand there also. They are doing a really nice job on the hiring front; again, it's not easy, but they are working awfully hard. They have built a culture and a social presence there that is getting a lot of people interested in the company; they are working hard and having some success in hiring those folks.

Operator: There are no further questions in queue at this time. I would like to turn the call back over to Mr. Thoren for closing comments.

Dan Thoren: Thank you very much. In closing, I will just say that we are very excited about the future of Graham, and I am especially grateful to the entire Graham Corporation team for their commitment, their resiliency, and their contributions to delivering on the quarter and to driving our future potential.

Thanks for your interest in our company. Hope you have a great day and look forward to talking to you again.

Note: This transcript has been edited slightly to make it more readable. It is not intended to be a verbatim recreation of the Graham Corporation (GHM) financial results teleconference and webcast that occurred on the date noted. Please refer to the webcast version of the call, which is available on the Company's website (grahamcorp.com), as well as to information available on the SEC's website (www.sec.gov) before making an investment decision. Please also refer to the opening remarks of this call for GHM's announcement concerning forward-looking statements that were made during this call.