

Operator: Greetings, and welcome to the Graham Corporation Fourth Quarter 2023 Financial Results Conference Call. [Operator Instructions] As a reminder this conference is being recorded. It is now my pleasure to introduce your host, Deborah Pawlowski, Investor Relations for Graham Corporation. Thank you. You may begin.

Deborah Pawlowski: Thank you, Christine, and good morning, everyone. We certainly appreciate your time today and your interest in Graham Corporation. Here with me on the call are Dan Thoren, our President and CEO; and Chris Thome, our Chief Financial Officer. You should have a copy of the fourth quarter fiscal '23 financial results, which we released earlier this morning. And if not, you can access the release on our slides on our website at ir.grahamcorp.com. You will also find on our website the slides that will accompany our conversation today.

Dan and Chris are going to provide their formal remarks, after which we open the line for questions. But as you will 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 discussion 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 by the company with the Securities and Exchange Commission. You can find those documents 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. However, you should not consider the presentation of this additional information in isolation or 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 slides.

We also use key performance indicators to help gauge the progress and performance of the company. These key performance metrics are orders, backlog, and book-to-bill. They are operational measures and the company's methodology for calculating these numbers does not meet the definition of a non-GAAP measure as that term is defined by the SEC, but -- so a quantitative reconciliation of each of these is not required or provided. But you can find the disclaimer regarding our use of key performance metrics at the back of our deck in the supplemental slides.

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

Dan Thoren, President, CEO & Director: Thank you, Debbie. Good morning, everyone. We made excellent progress with our strategy in fiscal 2023. We stabilized our vacuum and heat transfer technology business in Batavia, expanded our turbomachinery operations in Denver and further diversified our revenue with more defense, space and new energy business. We had record revenue of \$157 million for the year, a 28% increase over the prior year. This included about \$8.9 million of acquired revenue.

Importantly, our revenue growth reflected the success we have had with diversifying our markets. Defense was 42% of total revenue and our refining and petrochem markets combined were 31% of revenue. Space grew to 13% of revenue for the year and our other market category driven by new energy was 14% of sales. We are excited about the many opportunities we see in new energy.

The hydrogen market is developing quickly, and we provide both turbomachinery and heat transfer equipment for these applications. Another interesting market is lithium extraction from geothermal brine. We have historically provided surface condensers for geothermal power plants, but the added value of lithium extraction to the process is driving more investment into geothermal projects.

We ended the year on a strong note with orders of \$50.8 million in the fourth quarter and a record \$202.7 million of orders for the year. Fourth quarter orders included the \$23 million follow-on to provide power hardware for the MK48 Torpedo. Book-to-bill for the quarter and the year was quite healthy at 1.2 and 1.3x, respectively.

We continue to strengthen our operations, improve productivity, and deliver better gross margins. A better mix of business also helped. Gross margin was 16.2% for the year compared to just 7.4% last year due to the impact of cost and labor overruns on our U.S. Navy programs. As we complete the remaining two first articles from orders received several years ago, and as we have more revenue from better price contracts, we expect margins to further expand. We aren't stopping there, though, as there is still much more work to be done to drive operational excellence, which I'll discuss after Chris presents our financials.

One other topic I would like to address is related to a large space customer that filed for bankruptcy during the quarter. It was a disappointment to say the least. This had a net impact of about \$2.5 million on our results or approximately \$0.19 per diluted share. I was very pleased at the outcome for the year as we were able to achieve our adjusted EBITDA guidance provided at the beginning of the year despite this event, and it exceeded our raised revenue guidance.

With that, let me turn it to Chris to go into greater detail on the results. Chris?

Chris Thome, Chief Accounting Officer, VP of Finance, CFO & Corporate Secretary: Thank you, Dan, and good morning, everyone. If you turn to **Slide 4**, you can see that we had strong organic sales growth for our fourth quarter fiscal 2023, with record sales of \$43 million. This was up roughly 8% over the prior year period as well as the trailing third quarter. Our Space market led the way with \$6.9 million in revenue which was up \$4.6 million year-over-year. This 200% increase was due to growing demand from several key industry customers, some which have multiple programs with us, in this expanding market.

Aftermarket sales to the refining and petrochemical markets increased 45% to \$7.1 million or 17% of total revenue. Although aftermarket was up, refining sales were down \$4.2 million. This reflects both lower capital projects in this market as well as tough comparables due to timing as last year's fourth quarter had the benefit of a major project in India. We continue to be encouraged regarding the opportunities in the refining market, given the continued strength in aftermarket demand and the activity with our customers.

While defense sales were flat year-over-year, they were still very strong and represented 44% of our quarterly revenue, and at \$18.9 million was the second highest quarter for fiscal 2023.

For the quarter, sales in the U.S. were up 9% and represented 83% of our sales. International sales accounted for 17% of total sales and were 5% higher than last year. Gross profit and margin improved measurably over last year, given our much-improved execution on our U.S. Navy projects related to our vacuum and heat transfer business in Batavia. We also benefited from higher volume and pricing as well as improved mix with strong space and aftermarket sales. This more than offset the \$800,000 net impact to gross profit related to reserves for one of our space customers' bankruptcy that Dan discussed.

Selling, general and administrative expenses in the fourth quarter of fiscal 2023 were \$7.5 million, up \$1.4 million over the prior year. The increase was the result of \$1.7 million in reserves related to our space customer net of the associated performance-based compensation. Excluding the impact of this bankruptcy, SG&A improved to 13.7% of revenue compared with 15.4% in the fourth quarter of fiscal 2022 and reflects our improved fiscal discipline and cost containment measures.

If you will turn to **Slide 5**, you can see we had a net loss in the quarter of \$0.05 per diluted share or \$481,000. On a non-GAAP basis, which adjusts for amortization of intangibles, adjusted diluted net income and net income per share were breakeven. The net impact related to our Space customer had an approximate \$0.19 per share impact on diluted earnings per share in the quarter and was not added back in the computation of our adjusted amount.

Adjusted EBITDA was \$1.2 million for the quarter, which was 200% higher than last year's fourth quarter of \$400,000. I will remind you that last year's fourth quarter was impacted by higher costs associated with the investments we made to ensure we could meet our commitments for our strategic U.S. Navy programs, which is now paying dividend.

Turning to **Slide 6**. I will now touch on our full year results. As Dan mentioned, fiscal 2023 sales grew by 28% to a record \$157.1 million, with all markets and regions showing growth. We are extremely happy with this result as it was above the high end of our guidance that was raised last quarter. Sales to the Space industry increased 269% or \$15.4 million to \$21.2 million and represented 13% of total revenue. Additionally, aftermarket sales to the refining and petrochemical markets increased 26% to \$24.9 million.

Sales in the U.S. increased 30% to \$127.5 million and were 81% of total sales for fiscal 2023. Given our shift over the last couple of years to become much more of a defense business, our geographic mix of revenue is now more heavily weighted in the U.S. International sales were also up, increasing 18% to \$29.6 million.

Year-over-year gross margin improved 880 basis points to 16.2%. This reflects an improved mix of sales related to higher-margin projects, such as commercial space and aftermarket and improved execution and pricing on our defense

contracts. These increases were partially offset by the \$0.8 million net impact related to our Space customer.

Gross profit in fiscal 2022 included an estimated \$10 million impact related to labor and material cost overruns for first article U.S. Navy projects. In fiscal 2023, we completed four first article U.S. Navy projects, which were the source of these losses and remain on schedule to complete our remaining two first article projects by the end of the second quarter of fiscal 2024.

SG&A expenses in the full year of fiscal 2023 were \$24.2 million, including intangible amortization of \$1.1 million, an increase of \$2.9 million or 13%. The increase reflects the \$1.7 million net impact related to our Space customer and \$1.4 million incremental SG&A expense from the acquisition given the two additional months of Barber-Nichols operations in our current year results. Offsetting these increases were improved financial discipline as well as cost containment measures such as the reduction of outsized sales agents and delayed hiring of noncritical positions as well as the elimination of \$0.6 million in acquisition and integration costs incurred last year.

GAAP net income and net income per diluted share were \$0.4 million and \$0.03, respectively. On a non-GAAP basis, adjusted net income and adjusted diluted net income per share were \$2.5 million and \$0.24, respectively.

Turning to **Slide 7**. You can see how we are improving our balance sheet through improved profitability and fiscal discipline, all while deleveraging and investing for the future. Cash and cash equivalents on March 31, '23, were \$18.3 million, up \$1 million compared with the end of the third quarter and up \$3.6 million from the end of fiscal 2022. Cash generated from operations in the fourth quarter was \$5 million and \$13.9 million for the year. I should point out that cash flows for the year reflect the impact of \$13 million of customer deposits received from materials related to larger defense contracts. Going forward, we expect our cash flow to be lumpy due to the nature of these large contracts.

Capital expenditures for the fourth quarter of fiscal '23 were \$1.4 million and were \$3.7 million for the year or 2.4% of sales. This elevated level reflects our expansion and productivity improvement initiatives, which will support our organic growth opportunities. This strong cash generation allowed us to reduce our debt by \$6.6 million during the year, and our leverage ratio as calculated in accordance with the terms of our credit facility was 2.1x at year-end. At March 31, 2023, the amount available under our revolving credit facility was approximately \$10 million, providing us ample liquidity to support our strategic investments.

If you will now turn to **Slide 8**, I'll review our orders for the quarter and the year. We had orders of -- sorry, we had orders of \$50.8 million in the quarter, which were up \$27.2 million or 115% and included the previously announced \$23 million follow-on order for the MK48 Mod 7 Heavyweight Torpedo and a \$5 million order for a vacuum system for geothermal and lithium power production.

Aftermarket orders for the refining and petrochemical markets were \$11.5 million in the fiscal 2023 fourth quarter, an increase of 37%. The after-market business tends to be a leading indicator of future capital investments by customers in these markets. For the year, orders reached a new record of \$202.7 million driven by our defense business that was up \$53.5 million to \$116.7 million. This represented 58% of total orders for the year.

We believe these record orders validates the investments we made, our customers' confidence in our execution and the success we are having in winning new business across our diversified markets. This is not to discount demand growth in our other markets, including Space and new energy as well as after-market demand in our refining and petrochemical markets, which we are also excited about. After-market orders were up 34% for the year to \$40.6 million.

If you turn to **Slide 9**, we show our backlog, which given the heavy weighting now to defense provides us with strong visibility. Backlog at fiscal year-end was up 18% to \$301.7 million compared with the end of fiscal 2022. I should point out that there are no orders in backlog related to the Space customer who filed for bankruptcy. Approximately 50% to 55% of orders currently in backlog are expected to convert to sales in fiscal 2024, giving us strong confidence in our ability to deliver on our revenue and margin guidance. Approximately 25% to 30% of backlog is expected to convert to sales in fiscal 2025 and primarily relate to the defense industry.

Turning to **Slide 10**, we can review our guidance for fiscal 2024. We believe revenue will be between \$165 million to \$175 million, which suggests top line growth over fiscal 2023 of about 8% at the midpoint of that range. This is right in line with our long-term strategy to grow revenue 8% to 10% per year. These expectations as well as the results for fiscal 2023 allow us to raise our fiscal 2027 revenue goal, which is now expected to exceed \$200 million, the target just set a year ago.

From an adjusted EBITDA perspective, we expect \$10.5 million to \$12.5 million for next year, which suggests an adjusted EBITDA margin of about 6% to 7%. I should point out that these adjusted measures exclude approximately \$2 million to \$3 million related to the Barber-Nichols acquisition earn-out bonus as well as \$0.5 million to \$1 million of planned ERP implementation costs for our vacuum system and heat transfer operations in Batavia. We will still be impacted in the year by the first article in lower-margin projects that we entered into several years ago. As those roll out and we start to work on our better price contracts, employing our improved processes, we expect margins to expand more meaningfully in fiscal 2025 and beyond to achieve our low to mid-teen adjusted EBITDA margin goal.

With that, I will pass the call back to Dan.

Dan Thoren: Thank you, Chris. Let's turn to **Slide 11**. We continue to evolve our strategy as we advance the organization through steady growth and stronger profitability. Our vision is to build an exceptional company that provides mission-critical high compliance products to diverse markets. We believe we can succeed with our highly skilled workforce that is fully engaged because of our open culture that challenges each of us to do our best and align with our customers' engineering expertise, responsive service, and timely deliveries.

Our focus is on serving markets where our technology is critical to the success of our customers' process or application. This is how we have succeeded over time with our vacuum and heat transfer technology as well as our turbomachinery equipment. Think about the critical nature of our vacuum system on a refinery's distillation column. If it doesn't work, the output of the refinery is severely compromised. Similarly, failure of a torpedo propulsion system in an ocean conflict could be catastrophic.

Space communication satellites quit working if our thermal management pumps fail. Our engineering expertise in vacuum heat transfer and turbomachinery and our high compliance processes developed to create and qualify these solutions are key to our technology differentiation.

The second pillar of our strategy is operational excellence. We have many initiatives to continually improve the processes we employ in our operations. We have been consistently upgrading information systems in our turbomachinery operation and we'll initiate a long overdue ERP system upgrade for our vacuum system heat transfer operation.

We are making more investments in equipment like automated welding that eliminates rework and provides quick payback. Finally, expanding our shared services to gain economic advantage will continue.

A third pillar is our people. Our people are our most valuable asset and we are committed to grow and develop them to maintain a competitive advantage. We have had good success using engagement surveys to identify gaps in engagement. We then follow through with initiatives such as improved instruction, tools, communication, development programs and other resources to fill the identified gaps. Leadership development is actually quite advanced for a company of our size, and we have expanded trade -- skilled trades training through in-house weld schools, partnerships with community and academic resources and initiating a machinist apprenticeship program.

Finally, we will leverage our external stakeholders, including our communities, our suppliers, our lenders, and our shareholders to be a better business. This means strengthened relationships, improved communications and finding win-win solutions. We are making steady progress against our plan, and we're quite excited about the opportunities in front of us and encouraged with our stakeholders support of our journey of building better companies. With that, Christine, we can open the call for questions.

Operator: [Operator Instructions] Our first question comes from the line of Theodore O'Neill with Litchfield Hills Research.

Theodore O'Neill: Congratulations on a good quarter.

Dan Thoren: Thanks, Theo.

Theodore O'Neill: Yes. You've got some remarkable growth in orders here. And I was wondering if you could give us a little more insight into your success there. Is that new products? Is it taking market share from others? Was this business just there all along and you just started asking for it?

Dan Thoren: I think it starts with performance. So as our businesses can really perform for our customers, they're rewarding us with additional orders. I think both companies have an established relationship with lots of customers and those customers continue to come back as we perform. It just really points out the importance of the actions that we made a year, a year-and-a-half ago to invest in our businesses, to bleed a little bit, to make sure that our customers were satisfied. And ultimately, they're coming back to us. We are seeing some expansion in certain areas. But honestly, I'd say it's mostly that our customers are saying, thank you for really helping us out and here's more work to continue to help us out.

I'll expand that answer just a little bit, Theo, and give you a sense. A year-and-a-half ago, two years ago, supply chain was a challenge, and everything was really hard to get. And we attempted to go through heroic efforts, again, to help our customers get the equipment that they needed in that process. That the supply chain has improved some, but we are still seeing challenges in pocket areas. And in particular, where we're seeing challenges is in some of this high compliance related stuff. Lead times are still relatively long for raw material and simpler components.

What we see is that whenever we're asking for something that's special above and beyond, has high compliance, high testing requirements, et cetera, the supply chain is struggling with that. And it just goes to show that if you can perform at a high level and provide some really high-level service, high-level equipment that is checked out extremely well before supplying to the customers so they don't have problems once it's delivered to them. That scene is very valuable. And so I really like our niche of this mission-critical high-compliance equipment. And I think the world is struggling there. So I think our customers are starting to see how valuable that can be.

Theodore O'Neill: So you're saying that the high compliance products that you're providing to your customers is a differentiator compared to other suppliers?

Chris Thome: Absolutely.

Theodore O'Neill: Okay. I wanted to ask about Virgin Orbit. I just did some quick look up online during the call here. It doesn't look like that's coming back. Is that correct?

Dan Thoren: That is correct. They filed for Chapter 11. But in the Chapter 11 process, they did not find a going concern bidder. So they kind of transition to let's essentially get rid of the assets and lots. And so they've liquidated the majority of their assets at this point in time. And they don't appear to be coming back. Probably the good news is that some of the other launch market customers were interested in some of their assets. So they had bidders for their buildings, their inventory, et cetera. It's not wrapped up at this point in time. It's still an ongoing bankruptcy process. But yes, they were able to sell assets to other space companies.

Operator: Our next question comes from the line of Dick Ryan with Oak Ridge Financial.

Dick Ryan: Congrats on the good performance and guidance for the current year, Dan, and Chris. So a question on the guidance. In the slide deck, it shows virtually all the revenue you're guiding to is already covered by what's in backlog and expected to be delivered. You have this vulnerability with Space customer that doesn't appear to be included in that. Any other vulnerable areas within your backlog, and maybe the contrary or the complementary question there would be what could happen on the churn side of the business so that somebody could look at this and say, "Hey, there is upside to what you're currently guiding?"

Chris Thome: Yes, Dick, very good observation on your part. Like other companies, we're still seeing pressures, as Dan just talked about a little bit on the supply chain side as well as the labor side, although we have seen these conditions improve, they're still not where we were pre-COVID. So really, as you point out, we have the backlog, it just comes down to execution. So it really just comes to our team continuing to perform and risks outside our control, such as supply chain and labor.

Dick Ryan: Okay. Chris, as a follow-on. Looking at the year, you've got some delivery on the remaining two first articles during Q1 and Q2. But how should we look at the kind of the top line? How should the revenue line flow as we look at fiscal '24? Any other seasonality? Or as you look at projects, how should we kind of model the revenue growth for '24?

Chris Thome: As you know, Dick, we really don't have a lot of seasonality in our business. Our fourth quarter does at times tend to be a little bit higher as our teams are working to hit the goals for the year. So we don't see a lot of

seasonality built into our guidance.

Dick Ryan: Okay. Again on the aftermarket and the refining and petrochem side, your large installed base kind of drives that aftermarket business. But you indicate -- or you said that, that could be a leading indicator down the road. What does new projects in the refining and petrochem space look like either domestically or you've had some interest in expansion in China and India.

Dan Thoren: Yes. So domestically, it is picking up. We are seeing inquiry rates and opportunities domestically continue to grow. So it has been just horribly slow coming back domestically, but we're certainly seeing that coming back. As you noted earlier, we've kind of got our year already booked, and Chris indicated that it's all up to us to execute it. So if it doesn't come back as strongly as our pipeline has indicated, we've got plenty of work domestically for our crew here.

What we're seeing internationally is, China has opened up after their COVID shut down, but it's a slow reopening. So we are seeing an increased level of requested quotes on different programs. And we are quoting on those; how fast it comes back? Not entirely clear. But as it comes back, we'll start to see more orders in the second half of the year that's to build into our fiscal 2025.

India, we've got several different bids that are out there that are close to being announced. And so we're hopeful that we can continue our India presence. And then India looks like it kind of flattens out for a year or maybe two as they go through their election process. And then we fully expect that it kind of comes back on.

So it's really interesting to kind of follow all of these different markets. They're all in kind of different places. And so the ability to be flexible and be able to move with the market is something that the diversification that Graham has, has really been able to build over the last 2 years, provides a ton of value. So we're able to kind of move from one market to the other, use our backlog to fill holes and provide a lot more stability. And so we're in a much better place than we have been in prior years. Dick, you followed us for a long time and you watch the cycles, and so we're in a much better place.

Dick Ryan: Sure. One last one on capital allocation. When you look back, Graham had a nominal dividend that was eliminated during the tough couple of years you had. Now that you're back in compliance, does the dividend come back up in a discussion format at the Board level? Or how should we look at your capital allocation priorities over the next few years?

Chris Thome: Yes, Dick. As Dan and I laid out last year when we released our long-term strategic plan, our capital allocation starts with organic growth, right? We feel we have an abundance of capital organic growth opportunities to take advantage of. From there, if we have excess capital, we'll use it to pay down debt. And then hopefully, within the next few years, we can start looking at M&A again. And then after that, we would look to returning that back to shareholders. So we're comfortable with the capital allocation strategy that we have.

Operator: [Operator Instructions] Our next question comes from the line of Brett Kearney with Gabelli.

Brett Kearney: Congrats on the continued momentum. And Dan, I absolutely agree with your assessment of the landscape in U.S., I guess, potentially even global manufacturing, the ability for differentiation through reliability and performance. I guess can you talk about the opportunities you're seeing, some of the investments you're making, the ERP system, you noted some digital and automated tools to kind of cement, I guess, that vision for differentiation you see across the platforms?

Dan Thoren: Yes. Let me hit it generally and then I'll give you some specific examples. This continual improvement, continual investment in our business is in our minds extremely important. It's kind of like compounding and investing. When we're investing capital continually and wisely in our business, it becomes incrementally stronger, kind of like your bank account does as you continue to put money in there and compound.

So we love the notion of continuing to invest in ourselves and building a better company in the process. If we don't, it's -- there's an engineering term called entropy that basically means everything starts to come apart. So your processes drift. You don't have as well-trained employees, and ultimately, you have lower performance. In investing, inflation is that entropy. If you're not continuing to invest, the value of your investment starts to become less. So they kind of go hand-in-hand, which is really kind of interesting. So we are continuing to invest in our businesses.

Just last year, we put some significant money into Barber-Nichols to expand their capacity to support the MK48 program. And in that facility, our GM Matt Malone in Denver has told me that, that facility is within a week of going live. The Navy is excited about it. Our customer, our direct customer, SAIC is really excited about it. And essentially, that kind of foresight of investing in that is going to serve the Navy well as geopolitical tensions continue to rise. And we've all read more and more about that.

So that was one investment that we've made. Another one is on this automated welding equipment. And as we've got more and more manufacturing expertise within Graham to review our processes and review our products and kind of look at areas to expand, we've identified in these really tough welds that are hard for a person to actually follow a very complex weld path and be very, very consistent. We think that the automated welding equipment will enable us to have less defects, it will go faster, ultimately better quality in these really challenging welds. And so this investment where it makes the most sense where you can get good payback by investing in equipment like that is extremely important.

The ERP upgrade that you had asked about. In any business, especially a manufacturing business, the flow in the business is extremely important. And if there's lots of handoffs between people, there's lots of opportunities for confusion or mistakes or whatever. And as we can automate this more and more and be working with the same information throughout the value-add process, the quicker it goes and the less mistakes there are. And so we're really excited about being able to upgrade the ERP system in Batavia. We think that it's going to have a significant improvement on the flow of product through our factory as well as reduce some of the mistakes or process reworks essentially that we have seen.

So that whole information realm is getting tougher and tougher as our customers are wanting high compliance equipment, and they want the proof to back it up that it is high compliance. And so there's a ton of information that goes along with our hardware and making it available and trackable and findable and communicable within a digital platform is really important.

And so we continue to think about people and process and systems and investments in those. And -- then we've got our business unit saying, and products, don't forget about the product because we have some really cool opportunities. So to Chris' point, there are a ton of organic growth opportunities in front of us that we believe that we can give the stockholders a really nice return on investment as we allocate that capital appropriately.

Brett Kearney: Excellent. And actually, the follow-up I had was on this new opportunity, or I guess expanded opportunity, you guys are seeing with the geothermal lithium. Curious, what the potential funnel or kind of magnitude of market opportunity you guys are seeing there? And then, I guess, broadly, with all the developments and new energy and potentially the traditional energy markets coming back, I guess, how you're thinking about resources, prioritization, both capacity and personnel across the organization?

Dan Thoren: Yes, it's a great question. As you show the world that you're more and more capable, people want more out of you. And it does come down to prioritization and choosing the best programs to go after. The ones that have strategic importance, the ones that you can price higher for the benefit of higher returns for our shareholders. Those are the ones that we're kind of focusing on right now.

Again, you kind of pointed out some really cool opportunities that hydrogen -- the geothermal power has been around for a long, long time, but coupling it with this lithium extraction all of a sudden makes that a lot better for investors in those processes because there's additional yield other than the power that comes out of that process.

So being able to be flexible work with your customers to develop new equipment that's better suited for these new applications that come out, including hydrogen, our -- ultimately what we are trying to do as a business is make sure that we have that really strong capability, the ability to work with our customers to develop new products, modify existing product and follow them into some of these awesome opportunities.

So it's a lot of opportunity, and it comes down to prioritization and picking the right opportunities that benefit us long term, i.e., strategic as well as the highly profitable ones that benefit our stockholders.

Chris Thome: And Brett, just to address your comment about resources, right? We really have a top-notch human resources function within Graham at both our Arvada and our Batavia locations. Since last year, we increased our total workforce by 10%, and we increased our welding workforce by 25%, all that in a very difficult market.

So we're going to continue to look for different ways to improve, such as our welder training program and some of the other apprenticeship programs that we have in place and working with our local community colleges and trade schools.

And we're really excited about some of the opportunities that we have in front of us, and that's going to allow us to achieve this growth.

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

Bill Baldwin: A couple of areas here I'd like to focus on, if I could, Dan and Chris. On the aftermarket business, primarily almost entirely a domestic business for Graham in the refining and petrochemical area?

Chris Thome: Yes. Yes.

Bill Baldwin: And does that -- is it heavily weighted towards the refining side? Would that comprise the majority of the aftermarket would be on the petroleum refining?

Chris Thome: And petrochemical, yes.

Bill Baldwin: So how would that break out between petrochemicals and petroleum refinery, roughly, just half-and-half or...

Dan Thoren: It's going to be heavier towards the refinery, Bill. Here you're exactly right. I don't know that we have that breakdown...

Bill Baldwin: Well, I'm just trying to get a feel for how the business breaks out. And is most of your inquiries as far as aftermarket business going forward, is that primarily weighted to petroleum refineries? Is that where the heavy inquiries are and wherever you would expect, the heavier capital projects eventually unfold would be on the refinery side?

Dan Thoren: Yes. Historically, the majority of our equipment has been on the refinery side, and we would expect that the aftermarket inquiries follows that because that's the source, the installed base is the source.

Bill Baldwin: Right, right.

Dan Thoren: Yes, absolutely.

Bill Baldwin: With your very strong order picture there in aftermarket, how are you performing on the execution side, would you say Dan and Chris, are you pretty much on time with your deliveries and so forth on that? Or is that a -- here again, is raw material and labor shortages impacting their ability to handle that business as efficiently as you'd like to?

Chris Thome: Yes, you hit the nail right on the head, Bill. Our on-time delivery is where we'd like it to be because of the labor and the long lead times. However, we're firing on all cylinders with regards to aftermarket. In the current quarter, we had \$7.1 million of aftermarket sales, which is a record for us. So the team continues to execute and it's just really firing on all cylinders right now, and we're looking forward to what they can do once maybe some of these external forces free up and we get some of these process improvement and productivity initiatives in place.

Bill Baldwin: So, you think compared to your competition, though, would you say that you're definitely competitive and you're likely not to lose any potential business going forward because of these issues on delivery right now?

Dan Thoren: Yes. I think everybody is struggling in some areas with supply chain. And so some of the forgings that -- a lot of the forging houses are struggling quite a bit right now. You end up kind of seeing some weirdness around some of the specialty materials like gaskets for instance. And so specialty fastener companies are struggling quite a bit. They end up being high tolerance, high -- in some cases, high strength, high compliance types of components, and people are struggling with those. And so it's kind of a weird, Bill.

We see raw material, the pricing being a whole lot more stable, a little bit longer in lead times. But then you get into components that we're trying to buy, and every once in a while, you just run into something it's like, okay, I can't buy that and can't get that in-house for 6 months. And people's inventory is not built up very well yet. And so we're still running into challenges in supply chain and deliveries.

Chris Thome: But as you know, Bill, none of these challenges are unique to us and it is everyone is experiencing.

Bill Baldwin: Right, right, right. Regarding the lumpiness of your cash flow, it looked like your unbilled revenues were

pretty large that when that -- as you collect on those revenues, would that offset quite a bit your customer deposit situation. I mean customer deposits are a big source of revenue, but unbilled revenues were kind of a drain on you.

Chris Thome: Yes, absolutely.

Bill Baldwin: So, does that kind of balance out over time in terms of your cash flow?

Chris Thome: We think we have some upside on the unbilled levels, as you astutely pointed out. That's been one of the areas of focus of mine as well as the team ever since I started in. And we think that's going to start to free up over the course of this year and will definitely be a positive cash generator for us.

As far as our cash flows, though, given the size of these contracts and these customer deposits and changes in the unbilled revenue, we do expect our cash flows to be very lumpy. But over time, I think if you take a look at our EBITDA levels, that's more reflective of the cash that we're generating, it just is very lumpy in nature. Over time, we'll be improving and increasing.

Bill Baldwin: And lastly, can you wrap any potential numbers around the earnout liability post 2024? Is there a cap on that? I know you announced something on that lot a while back...

Chris Thome: Exactly, it is publicly released. So we can certainly talk about it.

Bill Baldwin: I couldn't locate it. So I thought...

Chris Thome: Yes, no problem. Let me walk you through it. So it's a 3-year program starting in our fiscal '24, so fiscal '24, '25, '26. The threshold level is \$2 million and up to a max of \$4 million each year. So over the three-year period, a max \$6 million to \$12 million in potential additional payouts in addition to the normal employee bonuses. And this was all negotiated shortly after the acquisition, it is all related.

Bill Baldwin: I remember that. I remember that. I just couldn't find the detail.

Chris Thome: Right. There's a growing EBITDA target. So for fiscal 2024, the target is \$8.75 million, and then that goes up to \$9.5 million for fiscal '25 and \$10.5 million for fiscal '26. So even though it is going to be a higher expense, we're going to see a higher EBITDA level that goes along with it. So it's all performance-based.

Bill Baldwin: That's what I was looking for. Well, you fellows and your team are doing a heck of a job in building a company here. So congratulations and best of success.

Operator: Our next question comes from the line of Gary Schwab with Valley Forge Capital Management.

Gary Schwab: Dan, Chris, great job, like everybody has said. A question about the lithium on the direct lithium extraction. There's a number of companies that are involved with this. Are you talking with any other companies in the U.S. or overseas?

Dan Thoren: So in general, I would say that we talk to a lot of different companies that need surface condensers for their power cycle. So yes, we do end up talking to quite a few of those folks. The Salton Sea application is unique. It's really kind of exciting. So this is the first one that we're providing equipment for. And when it's successful, I know that our customer wants to repeat it, and they've talked about that in the press. So I think that there's this ongoing opportunity to continue to support that.

It's -- again, geothermal power is a low-margin endeavor. It is a tough to make money in geothermal power. Coupling this lithium extraction with that process is really kind of nice from an economic perspective. But the process itself is a lot cleaner and more efficient than the standard put it all out into a lakebed and start to evaporate water. So it's pretty cool, and it's fun to be connected with that for a lot of different reasons.

Gary Schwab: Okay. You mentioned hydrogen, I think, 3 times in the presentation, but you really didn't expand on that. What kind of projects are you working on in hydrogen?

Dan Thoren: So hydrogen, as you know, can be pretty challenging. First of all, it's cold in its liquid form. And then from a material perspective, there's limited types of materials that you can use in hydrogen. And so it ends up being some

pretty specialty equipment that is used in hydrogen operations. So Barber-Nichols is a turbomachinery house, and they have built cryogenic pumps for, gosh, over 40 years. And so Barber-Nichols has been involved in providing cryogenic pumps, liquid argon, hydrogen, helium, all types of stuff. And with the major air products players have supplied turbomachinery to those major air products types of players. And so we see opportunities from them, and I can't name anything specific but we see opportunities with them to provide turbomachinery.

And then Graham has some unique heat exchange capability, Heliflow heat exchanger that can handle some really extreme temperature ranges and it's very applicable to hydrogen service. And so again, we have been supplying these heat exchanges to various companies that are involved in the production, the transportation, the distribution, fueling side of the hydrogen economy. And everybody is kind of working on their best solution to enabling the hydrogen economy. As you've seen, there's a lot of chatter in this market, and people are spending some big dollars to invest in it and develop the capability to support it. And so we're in there and we're participating, still too early to say what will come out of it. But again, a great place to be at this point in time.

Gary Schwab: Okay. Great. Let me just ask a couple of bookkeeping questions. On the 10-K, you said there remains approximately \$1 million to \$2 million in potential additional exposure. We're talking about Virgin Orbit related to the Space customer. Depending on the outcome of these proceedings and the asset sale, it says, however, at this time, the company does not expect any further impact in '24 or beyond. So does that mean that the \$1 million to \$2 million could be recaptured?

Chris Thome: Yes. I know it's a little bit confusing Gary. So let me walk you through it. So during the quarter, we reserved \$3.1 million for inventory and accounts receivable related to Virgin Orbit. That \$3 million charge resulted in a \$600,000 reduction in performance-based compensation since all our bonus programs are performance-based. So the net impact to the quarter and the year was \$2.5 million. .

As you know, bankruptcy proceedings are complicated, and they take some time to work themselves out. So we still have a little bit of exposure left on our balance sheet, which we feel very comfortable with what we reserved during the quarter. But again, these proceedings and us being able to capture value from what we have left on our balance sheet is uncertain, but we feel very comfortable with where we're reserved that at the end of the quarter and don't see any more impact for 2024. But never say never. So we wanted to at least put that qualifier out there.

Gary Schwab: Okay. So there's no recapture, you just don't expect any more reserve.

Chris Thome: Yes. So let's say the team is 100% focused on this. And if there is an ability to recapture, we're going to try to go after it, we're going to get it recaptured, but it's just too soon to tell, and we wanted to make sure that we are adequately reserved.

Gary Schwab: Okay. And then one last thing. In the third quarter, you were talking about your backlog and you said that of that backlog, 40% to 50% should be converted in 12 months. Now this quarter, you're saying that you are going from 40% to 50% to 50% to 55%. What sped up the delivery schedule?

Chris Thome: It's just the mix of the contracts that we have out there. As you recall, in the third quarter, we had some larger defense programs that we received, which we're not going to work on until like fiscal '24 through fiscal '26. So that extended it out a little bit. But then in the current quarter, we received the MK48 modification. So that brought it back in a little bit. So those numbers typically won't shift too much over time, but can vary a little bit. But typically, we see around that 50% level that's going to convert.

Gary Schwab: Okay. Okay. And actually, there is one other thing. They've been talking about the Artemis Moon Program scheduled for '24 and then '25. Is Barber-Nichols involved in that in any way?

Dan Thoren: You stumped me on that one. I don't think so, but I don't know that for sure.

Operator: We have no further questions at this time. I would like to turn the floor back over to management for closing comments.

Dan Thoren: Thank you. Thank you, everybody, for your time. I just want to reiterate the 3 key themes we hope you take away from our call. First, we are delivering on our promises. And while we have several years to achieve our fiscal 2027 goals, we are demonstrating our ability to get there. Second one is we have successfully diversified the business

and have expanded our customer base. Even with the event with our one space customer, we were able to absorb that and still deliver for the year. Third is we have a large opportunity set in front of us, and we have the strategy and team to continue to drive growth and improve profitability.

I hope you all enjoy the rest of your day. Thank you very much.

Operator: Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.

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.