

Operator: Greetings and welcome to the Graham Corporation First Quarter Fiscal Year 2024 Financial Results Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Instructions] As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Debbie 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 first quarter fiscal 2024 financial results, as well as the strategic investment release that we put out this morning over the wires. If you don't, you can access both releases and our Slides on our website at ir.grahamcorp.com. The Slides on the website will accompany our conversation today. Dan and Chris are going to provide their formal remarks, after which we will open the line for questions.

But if you will turn to **Slide 2**, I will 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 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 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. So, as a result, 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, if you would please advance to **Slide 3**. I'll turn it over to Dan to begin. Dan?

Dan Thoren, President, CEO & Director: Thanks, Debbie. Good morning, everyone. We reported better-than-expected results for our first quarter of fiscal 2024, giving us a strong start to the year. Revenue grew 32% to a quarterly record of \$47.6 million. Gross margin expanded to 23% and earnings per diluted share increased over 4 times to \$0.25. We had a few benefits to the quarter that were working in our favor. We had very favorable mix as a result of better priced projects and project timing. We also are seeing the impacts of improving execution, the expanded capacity we have created through productivity and increased direct labor, and better pricing in our backlog.

Aside from our strong results, we also announced a major strategic investment by a defense customer to expand our capabilities in our Batavia operations in support of the Naval Nuclear Propulsion Program. The investment will be used to ensure we can support the US Navy's shipbuilding plan. Chris will talk more about the investment and how we expect to recognize it through revenue over many years. We believe this investment validates the tough decisions we had to make in fiscal 2022. That year, we chose to make significant investments in order to deliver quality product in a timely manner to our customer. Back then, those decisions had a major negative impact on our earnings.

As I noted in the release, there is a lot to be excited about here at Graham. We have made measurable progress and we are seeing it in our results. But what is not as visible to the outside is the advancements we are making as an organization. We have quite a bit of ground yet to cover, but I'm very encouraged by the development of a culture of openness, challenge, and growth that I am seeing in the team. We are in the third or maybe fourth evolution of Graham since its inception in 1936 and IPO in 1968. Our history is important and a demonstration of the sustainability and resilience of the business. But our future is what drives us. And while we still have much work to do, I am proud of what our team has accomplished and their openness to change and advancement.

With that, let me turn it over to Chris for the financial details. 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 sales growth for our first quarter of fiscal 2024, with record sales of \$47.6 million. This was up 32% over the prior year period, as well as up 11% from the trailing fourth quarter. As Dan mentioned, the quarter was better than expected and benefitted from an improved mix of higher margin defense projects, as well as the timing of material receipts and the completion of subcontract projects which we originally expected in the second quarter of this year. Higher sales were also driven by better execution and improved pricing.

Defense led the way with \$22.8 million in revenue, which was up \$13.0 million over the prior year, a 133% increase. Commercial aftermarket sales to the refining and petrochemical markets continued to be strong and were \$9.2 million, up 49%. These improvements in defense and aftermarket more than offset softness in the refining industry and declines in the space market. U.S. sales were 80% of total revenue, up 35% year-over-year primarily driven by our growth in defense.

Gross profit and margin improved measurably. Gross profit was \$11.0 million and gross margin was 23.1%, up \$4.2 million and 440 basis points respectively. This reflects a very favorable mix as a result of better priced projects and timing due to build schedules.

We are also seeing the positive impacts on margin from improving execution, the expanded capacity we have created through productivity and increased direct labor, and better pricing in our backlog.

SG&A, inclusive of amortization in the first quarter of fiscal 2024 was \$7.3 million, or 15% of sales, up \$1.5 million over the prior-year period. Approximately \$900 thousand of the increase was attributable to higher performance-based compensation expense, including \$800 thousand related to the supplemental performance bonus payout to Barber Nichols employees in connection with the 2021 acquisition.

If you turn to **Slide 5** you can see we had net income in the quarter of \$0.25 cents per diluted share, or \$2.6 million, a notable increase over last year. On a non-GAAP basis, adjusted net income and net income per diluted share were \$3.6 million and \$0.33 cents, respectively, measurably improved over \$1.3 million and \$0.12 cents, respectively, for the same period a year ago.

Adjusted EBITDA grew to \$5.6 million, or 11.8% of sales, also reflecting the improvements in our business compared with last year's first quarter adjusted EBITDA of \$2.7 million or 7.6% of sales.

Turning to **Slide 6**, you can see how we are strengthening our balance sheet. Cash and cash equivalents as of June 30, 2023 increased 35%, or \$6.4 million, to \$24.7 million, compared with the end of the fourth quarter. Our cash generation is improving with better operating performance but is expected to be lumpy due to the timing of receipt of customer deposits and the corresponding material purchases associated with those deposits. Cash generated from operations in the first quarter was \$8.6 million.

Debt during the quarter was down \$400 thousand to \$11.3 million. As of June 30, 2023, the Company was in compliance with its lending agreement with a leverage ratio of just 1.6x. On June 30, 2023, the amount available under our revolving credit facility was approximately \$26 million and provides adequate liquidity to fund our strategic growth initiatives.

Capital expenditures for the first quarter of fiscal 2024 were \$1.5 million. We have updated our expectation for capex in fiscal 2024 to range between \$12 million and \$13.5 million. The \$6.5 million increase is primarily related to the strategic investment we received from our defense customer and our planned spending to expand our capabilities in our Batavia operation to meet the Navy's ship building schedule.

If you will now turn to **Slide 7**, I'll review our orders for the quarter. During the quarter, we had orders of \$67.9 million, which were up \$27.6 million, or 69% over the prior year and resulted in a book-to-bill ratio of 1.4x. Included in orders and backlog is the \$13.5 million strategic investment from a major defense customer we have been talking about and which we announced separately today. The investment is expected to flow through revenue over the next 8 to 10 years and will be associated with potential future orders and delivering on the \$8.5 million of follow on orders we received from that customer during the quarter.

Space orders were \$4.6 million in the first quarter fiscal 2024, down from the historically high \$7.3 million in the first quarter of fiscal 2023, but higher than the \$2.5 million in orders received in the fourth quarter of fiscal 2023. Space continues to be a strategic focus for us and a meaningful part of our business.

Turning to **Slide 8** we show our backlog. You can see that it is up 24% over a year ago and 7% sequentially, to a record \$322 million. The defense backlog is up \$60 million, or 31% over last year, and includes that strategic investment from the major defense customer I just mentioned.

Approximately 50% of orders currently in the backlog are expected to be converted to sales in the next twelve months and another 25% to 30% is expected to convert to sales over the following year. The majority of orders expected to convert beyond twelve months are for the defense industry, specifically the U.S. Navy.

Turning to **Slide 9**, we can review our updated guidance for fiscal 2024.

We are increasing our revenue projection to \$170 million to \$180 million, up \$5 million from our previous guidance on the lower and top end. Our new guidance suggests top-line growth over fiscal 2023 of about 11% at the mid-point of that range. This is right in line with our strategy to grow in the mid-to-high single digits annually in order to achieve our fiscal 2027 goal of greater than \$200 million in revenue. It also captures the better-than-expected performance in the first quarter which we expect will normalize for the remainder of the year.

From a margin perspective, we are updating the gross margin guidance to 18% - 19%, which is an additional 100 basis points over our previous guidance on the top and bottom end. Our guidance remains the same for SG&A percentage as well as for our effective tax rate.

Similar to revenue, we have increased adjusted EBITDA by \$1 million dollars at the top and bottom of the range to \$11.5 - \$13.5 million, which suggests an adjusted EBITDA margin of about 7% at the midpoint of the range. These increases to our guidance reflect our better-than-expected start to the year and incorporates more normalized performance for the remainder of the year.

As we start work on our better priced contracts employing our much-improved processes we expect margins to improve steadily each year in order to achieve our low to mid-teen adjusted EBITDA margin goal in 2027.

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

Dan Thoren: Thank you, Chris. I am on **Slide 10**. I have covered the pillars of our strategy on slide 10 previously. I would just like to reemphasize that it takes a team that understands our customers' critical challenges to help them find solutions, which drives our success. We are doing this on many fronts, which is also driving our diversification. We have much going on in space, new energy, cryogenics, refining and petrochem, as well as defense. We are well on our way to achieving our growth and profitability goals for fiscal 2027. And even beyond that, I believe our long-term outlook is very encouraging, and I hope you share in that excitement.

With that, Christine, we can open the call for questions.

Operator: Thank you. We will now be conducting a question-and-answer session. [Instructions] Our first question comes from the line of Theodore O'Neill with Litchfield Hills Research. Please proceed with your question.

Theo O'Neill: Thank you very much and congratulations on the great quarter.

Dan Thoren: Thanks, Theo.

Theo O'Neill: So, Chris, I was wondering if you can clarify the strategic investment, which sounds to me like this is for spending on CapEx. Yet, in your prepared remarks, you included in orders and backlog and say it'll be drawn down over the next eight years, which sounds like advance deposits.

Chris Thome: Yeah. Thanks for the question, Theo. I realize that this can be a little bit confusing. So, we received a \$13.5 million towards strategic CapEx purchases and a \$8.5 million of follow-on orders related to the strategic program which these investments relate to. You are correct. We are including those in our balance sheet as customer deposits, like a prepayment. However, when we spend the money on the CapEx, it's going to go through as capital expenditures. So, it's going to cause some lumpiness in our cash flow statement over the next several years here. Under the terms of the agreement, we're not allowed to charge our customer for the depreciation on this equipment, and it is related to specific orders for this strategic program. So, we determined that it is really revenue. So, it's going to be flowing through revenue as we work on the current orders, as well as potential future orders over the next 8 to 10 years.

Theo O'Neill: And will this have sort of a one-time use for this particular customer and application or is there other usefulness to this?

Chris Thome: So, we do have to provide our customer's strategic program priority while we're using that machinery and equipment. But if there is excess capacity, we can certainly use it on other revenue-generating operations, and the equipment is all in our name at the end of the day.

Theo O'Neill: Okay. Can you give us an update on your CapEx plans for some of the long lead time items and also update us on how it's going to grow your welding capacity?

Dan Thoren: Yeah. So, as Chris said in his remarks, I think there was like \$6.5 million that'll be charged to the CapEx this year, right?

Chris Thome: An increase of \$6.5 million, yeah.

Dan Thoren: Yeah. So, in that strategic investment, there's everything from building additions to machine tools for drilling holes and turning different raw materials, so turning and milling machines. There are welding machines associated with that. There are all kinds of different rolling machines. And so, it's a wide variety of things. As you kind of look at all the machines that are needed to kind of process those particular heat exchangers for our customer, they're basically helping us get tooled up to really push those through quicker than we would be able to on our own. So, yeah, there's definitely welding machines in there, but there's everything else too.

Theo O'Neill: Okay. Thanks very much.

Dan Thoren: Yeah. You're welcome, Theo.

Chris Thome: Thanks, Theo.

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

Gary Schwab: Yeah. Hi Dan. Hi Chris. I think you surprised a lot of people with this release. Good work.

Dan Thoren: Thank you, Gary.

Chris Thome: Thanks, Gary.

Gary Schwab: Anyway, it's been a year since you delivered your first two steam condensers. The next two should be very close to delivery, or have you delivered them already? Can you comment on that?

Chris Thome: Yeah. So, we did deliver one more at the beginning of July, and we have one more that's scheduled to go in the third quarter of this year.

Gary Schwab: Okay, great. I wanted to ask you about this. My daughter just moved into a new house and she bought a pair of six-drawer dressers from IKEA that she asked me to assemble. And I spent about half the time building the second dresser than it took me to build the first one. But I don't think I'd save much more time on a third one. Now, you mentioned how your teams are questioning and challenging each other. Were there significant new practices or innovations developed where you saw like a real step change in savings and productivity on your second articles? And how much more do you think there'll be in labor innovation that you can squeeze out of a third article?

Dan Thoren: Yeah. So, what you're describing is a learning curve. And essentially, you learn by building the first one and you can apply those lessons learned to the second one. And you don't have to improve your processes, improve your tools, anything, and you actually get some benefit just from the learning of how to do things and in what the sequence, et cetera. But then, if you start to look at your process and look at how you can reduce time or make processes go in parallel or things like that, you can start to get even further down that learning curve.

So, in the manufacturing industry, you'll see learning curves that are very steep at the very beginning for small quantities. And then, as you increase quantities or basically accumulate builds, you'll start to see that learning curve flatten. And each one of those learning curves really is product and process specific. And so, I wouldn't even attempt to start to name savings from first article to second to third to fourth to fifth, just because they are so dependent upon the process and the products, and then ultimately the people. But we are very active and looking at those processes, mapping those processes, helping our folks with better tools and better supervision and timely receipt of materials, and gosh, all of that. So, it's the nature of a manufacturing business that if you have one, you and you really enjoy the improvements that you can make in your process and your people over time.

Gary Schwab: So, you think you can squeeze a lot more margin out of the third articles that you'll be building over the second?

Dan Thoren: As you build more of them, the improvements or the reduction in time starts to decrease for each one, and that's what they kind of called moving down the learning curve. So, you'll save probably the most between the first and the second, a little bit less between the second and third. You'll save a little bit less between the third and the fourth, et cetera.

Gary Schwab: Okay. So, it's still there. There's still savings.

Dan Thoren: Yeah. It's absolutely still there. It just flattens.

Gary Schwab: Right. And as far as what you were expecting in efficiency and productivity on the second article, did it meet what you were expecting when you first started on the first article and thought about the second, or did you surpass what you thought you would get to?

Dan Thoren: Good question that I don't know the answer to actually. There were definitely the savings. Did our guys and gals really predict or not, I couldn't tell you.

Gary Schwab: Okay. I didn't know if you've figured – predicted a margin that you thought you would save or an additional margin you would make or shorten your labor time on the second one over the first.

Dan Thoren: Yeah. I'm sure they have, Gary, but I couldn't quote it to you.

Gary Schwab: Okay.

Chris Thome: And it's different for every program, and as you know, we have multiple programs in the backlog.

Gary Schwab: Right, right. Of course. All right. Well, thanks very much and great job. Thank you.

Dan Thoren: Thanks, Gary.

Chris Thome: Thanks, Gary.

Operator: Our next question comes from the line of Brett Kearney with Gabelli Funds. Please proceed with your question.

Brett Kearney: Hi, guys. Good morning and congrats on the continued momentum.

Dan Thoren: Hey. Thanks, Brett.

Chris Thome: Thanks, Brett.

Brett Kearney: Just following up on the strategic investment, this is for, I guess, to get yourself aligned with your customer for new work you all will be bidding on with the US Navy going forward?

Chris Thome: Correct. So, we already did have a few orders in our backlog. Right after we received the PO for the strategic investment, we received another order for several more units. And then, we will have the opportunity down the road to bid on other jobs and other units as they come up for bid.

Brett Kearney: Okay, excellent. And then, it sounds like incorporated in this – in your plans is some more advanced machine equipment. How are you guys thinking about the labor needs to meet the ramp on these new lines?

Chris Thome: Yeah. That's a great question, Brett. Just like everyone else, we're not immune to the difficult labor market that's out there. I will say that, overall, our human resources team has done a fabulous job. Our labor is actually up 44 people since this time last year, which is about a 9% increase. Then, within our budget, we still expect to increase our labor force another 8%. So, we've done a great job till now. As you can imagine, to grow your revenue 8% to 10% a year, you need to build your workforce equivalently. We've been able to manage through it so far, and our HR team is doing great with the programs that they have with the local community colleges, the Arc + Flame welding program that we partnered with the local community colleges with and other programs that are out there. So, they've done a really great job being able to keep up with our growth to this point.

Brett Kearney: Definitely. Thanks so much, Chris.

Chris Thome: Thank you.

Dan Thoren: Thanks.

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

Dick Ryan: Thank you and also congratulations on a strong report, guys.

Dan Thoren: Hey, Dick. Thank you.

Dick Ryan: Say, Chris, I think you mentioned better pricing in backlog. Is that more mix, the end market composition there or actually are you seeing better pricing? And if you are, what markets would that be occurring in?

Chris Thome: Yeah. So, we are seeing better pricing, and that's in several different areas, right. We've been able to – because of the demand, we've been able to increase pricing in aftermarket several times over the last year. So, that's part of it. As you know, after you get done with your first article programs, when you're bidding on the next articles, it's based on the hours that you spent on the first, I'll call it, inefficient unit, right. So, you get a natural bump in price because it's based on the first article hours. But at the same time then, you do get, as Dan has just been talking about, more efficient on producing those. So, that'll help expand the margin as well. So, the mix is coming from, again, higher priced second and third article units, as well as, as I mentioned, the aftermarket.

Dick Ryan: Okay.

Dan Thoren: And I think I'd add to that that we're able to get a little bit better pricing even on the commercial side, the refinery/petrochem. We are seeing that heat up a little bit. Certainly, the aftermarket has been busy for the last year-and-a-half. We're seeing some capital projects starting to come through. The pricing on those, we're able to get a little bit better pricing than we have in the past even on the commercial side. So, it's improving, I would say, across several different markets.

Chris Thome: And I guess, Dick, I would just add to that. We've also been putting and stressing to the team about going back, where our customers caused the delay or they caused the cost to go up for either more engineering that they request or if there was a delay in the order and material prices go up, right. We've been encouraging the team to go back, and we've been successful in going back and negotiating change orders and increased the PO prices to compensate us for that. So, that's also being built into some of the pricing that you're seeing as well.

Dick Ryan: Okay. Yeah, because I know you're – I thought you're going to be putting more emphasis going after some of that aftermarket business. So, it's good to see that that's bearing some fruit. Dan, you briefly mentioned seeing some pick-up on the energy side. Is that domestic? What are you seeing in your India and China operations from an energy standpoint?

Dan Thoren: Yeah. So, we have seen an uptick domestically. We won a big order in India, and China has been really slow coming out of COVID. Our pipeline domestically really has cleared out a little bit here this last quarter where we got several different orders. But we just haven't seen the China market come back as quickly as we thought that we would at this point.

Dick Ryan: What was the size of the India award?

Chris Thome: It was about \$9 million.

Dick Ryan: And what's the delivery timeframe on that?

Chris Thome: I'd say over the next year-and-a-half.

Dick Ryan: Congratulations, and it's good to see that all your efforts from fiscal 2022, the hard decisions are starting to pay off. Thank you.

Dan Thoren: Thanks, Dick.

Chris Thome: Thanks, Dick.

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

Bill Baldwin: Hey. Good morning, Dan, and Chris.

Dan Thoren: Hey, Bill.

Chris Thome: Good morning, Bill.

Bill Baldwin: I would just like to hear your comments and insights on what you're seeing right now in terms of activity or what kind of projects you're kind of aiming for in terms of potential future activity regarding your new energy initiatives and your cryogenic initiatives that I know you're involved with.

Can you provide a little color there as to what types of projects you're working on or looking at?

Dan Thoren: Yeah, we can. I would say that the hydrogen inquiries have increased. So, there's a lot of these air product types – the industrial gas types of companies – that are looking at hydrogen and see a real opportunity to start to serve that market in the future. I actually went to a hydrogen conference in Houston last month and kind of learned what was going on there. Lots of technology development, lots of investment in infrastructure for hydrogen production, distribution of hydrogen, fueling of hydrogen vehicles, et cetera. Went to the National Renewable Energy Lab to kind of understand what they're doing. Quite a bit of activity on the hydrogen side there also. So, I would say that the biggest thing that we're seeing is really probably on the hydrogen side, and people are interested in all phases from production all the way through fueling using hydrogen. The future is anybody's guess as to how it really unfolds. It's kind of interesting to compare it to the space environment that we saw a decade ago where it was all government, and now we're starting to see quite a few commercial companies starting to put their own money into it. So, pretty interesting.

Then, small modular nuclear, we continue to see just a steady push to develop technology there. There are several different companies that are working in different technology areas, and we're trying to support as many as we can. That's a much longer effort, I think. I would suspect that the hydrogen effort, if the hydrogen economy really goes, will pay dividends sooner than the small modular nuclear. But those are the two biggest areas that we're involved with right now. Now, Graham is also supporting some of the biodiesel sustainable aircraft fuel, and those are more on the process side. So, some of the heat exchanger vacuum equipment that Graham has made for a long time is being used in those plants also. So, we're covering quite a bit of the new energy space, and we'll see which one really takes off here.

Bill Baldwin: Thank you, Dan. And any specific comments on the cryogenic projects or types of activities going on there? Or is that part of hydrogen?

Dan Thoren: That's hydrogen, yeah. They're using hydrogen gas and they're also looking at liquid hydrogen for fuel and transport, as well as some of the other carrier type fluids like ammonia. So, all of that is being discussed about in the distribution and transportation of hydrogen.

Bill Baldwin: Yeah. Okay.

Dan Thoren: So, yeah, that's where the cryogenic pumps come in for the liquid hydrogen.

Bill Baldwin: Okay. Thank you very much.

Dan Thoren: Yeah. Good talking to you, Bill.

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

Dan Thoren: Thank you for joining us today. We continue to demonstrate progress with our plan, and we are putting proof points on the board. We have lots of opportunity to continue to grow and diversify. I look forward to updating you further with our second quarter. Enjoy your day.

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.