

**Operator:** Greetings. Welcome to the Graham Corporation Third Quarter Fiscal Year 2024 Financial Results Call. [Operator Instructions] Please note, this conference is being recorded. I will now turn the conference over to Deborah Pawlowski, Investor Relations for Graham Corporation. Thank you. You may begin.

**Deborah Pawlowski:** Thank you Daryl, 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. Dan and Chris are going to provide their formal remarks, after which we will open the line for questions. You should have a copy of the third quarter fiscal 2024 financial results that were released this morning. If not, you can access the release on our website at [ir.grahamcorp.com](http://ir.grahamcorp.com), along with the slides that accompany today's discussion.

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](http://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 reconciliations 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 ratios. 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. Reflecting on the past few years, we firmly believe that our business is now in a significantly improved position due to the strategic actions taken. This has been a great team effort and I would like to thank our customers, employees and service providers for their contribution to our turn-around.

In the third quarter, our performance demonstrated robust strength, underscoring the consistent execution of our strategic approach aimed at cultivating high-quality, top-line growth along with margin-accretive initiatives to enhance our future earnings potential.

Notable highlights from the quarter included gross and adjusted EBITDA margin expansion, a substantial increase in bookings that led to a record backlog of nearly \$400 million, and we refinanced our debt with a lower cost, and more flexible credit facility, further solidifying our financial framework.

Our bottom line was muted, however, given some atypical expenses that Chris will talk to, but on an adjusted basis, net income was up over 180% to \$2.4 million.

We generated strong cash from operations during the quarter given recent working capital initiatives along with stronger financial discipline. This enabled significant debt paydown during the quarter and strategic investments, both organic and inorganic.

We highlight on Slide 4 a significant investment made during the quarter, which was the acquisition of P3 Technologies. This was a great bolt on business which brings highly complementary technology that enhances and expands our turbomachinery solutions, engineering and development team. Their patented technologies deepen our reach into existing space and new energy markets and create greater diversification with the addition of medical markets.

From a financial perspective, P3 brings about \$6 million of annual revenue, accretive gross and adjusted EBITDA margins and approximately \$6 million of backlog. They also have what we feel is a lot of high-growth pipeline opportunities that are highly complementary to our Barber-Nichols turbo machinery business. In fact, in the short period they have been with us, that business has already proven instrumental in fortifying some of our solution offerings and

has amplified our financial profile, including being accretive to earnings in the third quarter. It is important to note that given this quarter's robust cash generation, we were able to repay nearly all of the debt associated with the acquisition during the third quarter.

Together, we believe we have a bright future as we aim to create opportunities for product and technology integration to provide more effective solutions across multiple markets.

As we look forward, we are focused on advancing Graham by building a collaborative culture across our brands, leveraging best practices, and advancing employee development to reinforce our core capabilities of precision machining of critical turbomachinery components and specialty welding for fabrication of critical equipment for large heat transfer and vacuum applications. Our confidence remains high in our ability to consistently execute our strategy and leverage the multitude of opportunities before us.

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. As Dan highlighted, our results for the quarter include approximately two months of operations from P3, which was acquired on November 9, 2023.

On Slide 5 you can see that we had strong growth for our third quarter of fiscal 2024, with sales of \$43.8 million. This was up 10%, or \$3.9 million, over the prior-year and included approximately \$1.0 million of incremental sales from P3.

Strong sales in the commercial aftermarket continued to help offset the cautious spending on capital projects in the refining and petrochemical industries. Aftermarket sales were \$8.6 million in the quarter, up \$3.2 million or 59%, over the third quarter of last year. Defense revenue was also solid with an increase of \$2.6 million, or 12%, reflecting higher priced contracts, as well as increased capacity and direct labor hours.

We did see a decline in the space market, which had a lot to do with project timing, as we had strong order growth during the quarter that I will talk to in a few slides. We are still seeing the impact of the Virgin Orbit bankruptcy last year but should finally cycle thru that once we finish out fiscal 2024. P3 helped offset some of this decline and we expect further lift from that acquisition within this industry mix, as well as a robust pipeline of other opportunities in the new energy, defense and medical markets.

U.S. sales for the quarter were 84% of total revenue and continue to reflect the size and growth of our defense business.

Looking to the chart on the right, gross profit was another positive story with an increase of \$3.5 million, or 56%, to \$9.7 million in the third quarter. The 660-basis point expansion of gross margin reflected higher volume and the related improved absorption. Mix also played a role, with higher margin commercial aftermarket sales, as well as the margin accretive sales from P3. And lastly, we are benefiting from improved execution and pricing on defense contracts.

Turning to Slide 6, you can see our bottom line and Adjusted EBITDA results. As Dan mentioned, net income was impacted by a number of items this past quarter. SG&A, excluding amortization, was \$8.4 million, or 19% of sales, up from 13% of sales during last year's period. The increase reflects higher performance-based compensation, including a \$1.3 million supplemental performance bonus for Barber-Nichols employees in connection with the 2021 acquisition. Also contributing to the increase in SG&A was P3 acquisition-related costs, increased professional fees largely related to our international operations, and initial ERP conversion costs.

Separately, on the income statement you will also see a line item for our costs associated with the debt extinguishment during the quarter, which amounted to \$0.7 million.

When excluding many of these atypical costs, on a non-GAAP basis, adjusted net income was \$2.4 million, or \$0.22 cents per diluted share, up 183% from a year ago.

Similarly, you can see the improvements in Adjusted EBITDA, which grew 72% to \$3.9 million, or 8.8% of sales, up 320 basis points.

Turning to Slide 7, you can see how a strong quarter of cash generation enabled us to further improve our balance sheet, while still making strategic investments.

At the beginning of the quarter, we refinanced all of our outstanding debt with a new, five-year, \$50 million dollar revolving credit facility that matures in 2028. This facility provides us with reduced borrowing costs and greater flexibility to fund our long-term strategic growth goals.

Cash generated from operations in the third quarter was \$7.6 million and \$19.5 million for the year-to-date period of fiscal 2024. We utilized some of this cash to reduce our debt balance by \$7.9 million to \$3.0 million at quarter end.

P3 was acquired with a combination of cash, stock and contingent earn-out based upon the future performance of P3. As Dan highlighted most of the debt associated with the acquisition was paid off during the quarter. However, in January 2024, after the quarter ended, we paid off the remaining \$3.0 million of debt, currently leaving us debt free.

Capital expenditures of \$1.9 million in the quarter and \$5.2 million year-to-date were focused on capacity expansion, productivity improvements and the start of the ERP implementation at our Batavia facility. In total, we expect the ERP project to cost approximately \$2.0 million in capital and \$1.0 million in expense with an anticipated go live date of about a year from now.

We decreased our expected fiscal 2024 capital expenditures, to now be in the range of \$8.0 million to \$10.0 million primarily due to the projected timing of cash outflows. All projects continue to move forward at a steady and thoughtful pace.

If you will now turn to Slide 8. During the quarter, we had record orders of over \$123 million, which were up 6x over the prior year and resulted in a book-to-bill ratio of 2.8x. These were largely follow-on orders for critical U.S. Navy programs, although aftermarket orders for the refining and petrochemical markets remained strong at \$7.8 million. We also saw nice order flow from our Space customers of \$6.1 million, which was up \$4.5 million year-over-year and double the sequential quarter and remains a key growth driver in our diversified portfolio.

Turning to Slide 9 you'll see that our backlog is nearly \$400 million, also a record level, which provides several years of visibility given the long lead times of some of our defense contracts. The P3 acquisition added \$6 million to our backlog.

Approximately 40% of our backlog is expected to convert to sales in the next twelve months and another 25% to 30% is expected to convert to sales over the next one to two years. The majority of orders that convert beyond twelve months are for the defense industry, specifically the U.S. Navy.

Turning to Slide 10, we can review our guidance for fiscal 2024.

Given our strong performance year-to-date and the addition of P3, we have raised our revenue expectation to be between \$175 million and \$185 million for fiscal 2024, up \$5 million at the bottom and top ends. This implies top-line growth over fiscal 2023 of 15% at the mid-point of that range.

From a margin perspective, our gross margin guidance is approximately 20%, up from the 18% to 19% we guided last quarter. Additionally, our expectation is for SG&A, including amortization, to be between 16% to 17% of sales, up one percentage point over our previous guidance. This includes costs associated with the supplemental performance bonus for Barber-Nichols employees, the P3 acquisition costs, as well as ERP implementation expenses at our Batavia facility.

We also raised our Adjusted EBITDA guidance for fiscal 2024 to range between \$15 million to \$16 million, up from our previous guidance of \$11.5 million to \$13.5 million. The new range implies an adjusted EBITDA margin of about 9% at the midpoint. I should point out that our adjusted EBITDA guidance excludes the SG&A items I just mentioned, and approximately \$0.7 million of debt extinguishment charges.

We are delivering continuous improvement and are on track to achieve our fiscal 2027 goals. We continue to expect eight to ten percent annualized organic growth per year, which implies \$225 million to \$240 million in revenue for fiscal 2027. And, with margins improving steadily, we are on target to achieve our low to mid-teen adjusted EBITDA margin goal.

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

**Dan Thoren:** Thanks, Chris.

Significant strides are being made within our organization, yet there remains a lot of work to be done. Our team is devoted to the ongoing pursuit of our strategy for sustained growth and I am grateful for their unwavering dedication, enthusiasm and diligent efforts.

Our record backlog and the acquisition of P3 add up to a bright future for Graham. Numerous opportunities lie ahead, and we anticipate that these will play a pivotal role in propelling our growth and bolstering our future earnings.

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

## Question & Answer

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

**Theodore O'Neill,** *Litchfield Hills Research, LLC*

Congratulations on the good quarter. Dan, in your prepared remarks, you mentioned that there was a pipeline of high-growth opportunities that you got as part of the P3 acquisition. I was wondering if you could give us some more detail on that?

**Dan Thoren** Yes. They're mostly on the space side. And I probably won't be able to give you a whole lot of detail there just because of NDAs. But P3 has been working in propulsion pumps, fluid management pumps for space applications. So, they're actually an awesome complement to Barber-Nichols from that perspective and really -- probably deepens our engagement with the space community. The other thing I get excited about P3 is they're also involved in some of the new energy-waste-heat-power-gen-types of applications. And then they do cryogenic pumps, which really get into some of the medical applications that they're trying to apply those to. And then they've got some very cool IP that we believe -- we haven't scratched the surface on that yet as far as how and when we would like to take that to market. But that's definitely something we're pretty excited about.

And one of those is what they call a multichannel diffuser, which is an efficiency enhancement that can be applied to basically any pump, pumping liquids. And so, we're pretty excited about that. And then their cryogenic pump capability really complements, again, Barber-Nichols that is mostly centrifugal types of pumps and P3 brings a positive displacement pump that complements that. So, lots of really cool things. And Phil and his team are top-notch engineers and we're really, really excited to have them.

**Theo O'Neill:** Okay. And Chris, in the press release, you say that the improved working capital was largely due to changes in payment terms related to large defense customer. Can you give us any more detail on that, what that means?

**Chris Thome:** Sure. So, for the last couple of years, the team has actively been working on putting in stronger discipline with regards to capital management, basic blocking and tackling, collecting receivables sooner, pushing out payment terms where possible; and several of our large defense contracts had really unfavorable payment terms, where basically, once you got past 50% production, you couldn't bill anymore until project completion. Well, as you know, some of these projects can go on for several years. So, that was really putting a cash restraint on our business.

And over the past -- I would say, 3 to 4 quarters, we were able to renegotiate some of the payment terms where we're now billing more milestones and more on a percentage-complete basis. So, that really provided a significant uplift to the cash generation over the last couple of quarters. Additionally, as you know, with the \$123 million of orders that we had this quarter, and then a large amount of defense orders over the last year, a lot of those pay for the materials upfront. So, we've been able to collect that cash up front, but we'll have to pay for that inventory as it comes in. So, as we've discussed in the past, we fully expect our cash generation from quarter-to-quarter to be pretty lumpy. But the team has done an excellent job really improving some of the payment terms and helping that cash flow along.

**Theo O'Neill:** Okay, and given the growth that you're experiencing there, are there any potential CapEx expenditures that you'll need to make, or have to make investments in skilled employees to keep up with it all?

**Chris Thome:** Yes, definitely. As you know, we've guided for CapEx of \$8 million to \$10 million for this year, which is about 5% at the midpoint of the guidance. And we think that our CapEx spend is going to be in the 3% to 5% range over the next several years just to support that growth in the facility expansion that you just mentioned. So, yes, we certainly expect capital expenditures to remain elevated for a few years here.

**Operator:** Our next questions come from the line of Dick Ryan with Oak Ridge Financial.

**Dick Ryan,** *Oak Ridge Financial Services Group Inc., Research Division*

Congratulations, also, on the great quarter, guys. Chris, looking at the OpEx, your leverage gets a little obscured with all the puts and takes in this quarter. You still guide to that 16% - 17%-ish range for this year. I know you're not providing guidance for '25 yet, but is there any reason to think that kind of the SG&A level at this percent of sales changes materially with your aspirational goals going into '27? Or will we start seeing the leverage kind of kick in over the next few quarters?

**Chris Thome:** Sure. Well, thanks for the question, Dick. As I outlined in my comments today, we had some unusual items in the quarter with regards to SG&A. We've been recording the Barber-Nichols earnout bonus for the last several quarters. We also had some elevated acquisition costs as a result of the P3 acquisition. Professional fees were a little bit elevated related to our foreign subsidiaries. And then as you know, we've kicked off the ERP implementation. So, talking to those items, the Barber-Nichols performance bonus is going to be with us for several years. As we've discussed on other calls, it's a 3-year program for fiscal '24, '25 and '26. So that's going to be around for a while here. The ERP implement really just kicked off in the current quarter in earnest. So, as I mentioned in my prepared remarks today, we expect that to be about \$1 million of expense over the next year. So, I would expect SG&A to be a little bit elevated for the next year here as we work through these things. But then, yes, you're certainly right. The leverage should kick in. And by the time we get to 2027, it should allow us to get to those low to mid-teen EBITDA margin percentages.

**Dick Ryan:** So, Dan, the strength you've seen in the aftermarket over the last few quarters, is that still kind of a potential precursor of what you might see on capital budgets in refining and petrochemical -- or what's your view of those end markets?

**Dan Thoren:** Yes. So, I guess, first of all, the aftermarket is remaining strong. So, we're still seeing that elevated order level continuing on. We are seeing and hearing about some nice capital projects that our customers are planning for this year and we're starting to bid on. So, we're encouraged. But again, it will not be the big boom, I think, like Graham has seen in the past. So, we're encouraged. We're happy that the aftermarket continues on strong, and we're getting ready to -- if there is a significant uptick, we've been working pretty hard as far as training new employees at our businesses and the supply chain challenges are starting to work out and less of an issue there. So, I think that we're going to be in a pretty decent position if and when that does take off.

**Dick Ryan:** I think Chris mentioned some increased professional fees in your international operations. Does that reflect -- you said maybe some of these early capital project discussions? Or is that something else?

**Chris Thome:** Yes, I could take that one, Dick. As we disclosed in our 10-Q today, earlier in the year, our audit committee received a whistleblower complaint from our India subsidiary. And as a result of that, they launched an investigation, which included hiring outside legal counsel and some forensic professionals. That investigation did confirm the whistleblower complaint, which led to a broader investigation where other misconduct was identified -- mostly with regards to improper expense reimbursements. As we disclosed in the 10-Q, the impact was relatively minor. It was about \$150,000 in total over 4 years, but that did result in an increase in professional services fees, probably about \$750,000 year-to-date that we've incurred in that investigation.

**Dick Ryan:** Okay. So, Dan, one of the arguments for P3 was Graham can bring this scope to really expand the potential of both companies. You talked a lot about entering some new market opportunities with P3. When you talk -- bringing scale to the story, is that broadening the end markets? Or is there a potential to get deeper into the space business, let's say, when you guys are combining efforts?

**Dan Thoren:** Yes. We see it as both, Dick. So P3 has connections to markets that Barber-Nichols doesn't necessarily have. And they've -- they're a really strong engineering group. And so, they're actually bringing some strength on the engineering side to Barber-Nichols also. So, we see -- probably some breadth that comes with P3. P3 doesn't necessarily have the production capabilities that Barber-Nichols has. So, we're actually going to be able to satisfy P3's customers on the production side also going forward. So, I see it as a real win-win, in that it is broadening and it's a deepening with some of the technology that P3 brings to the table.



**Operator:** [Operator Instructions] Our next questions come from the line of Gary Schwab with Valley Forge Capital Management.

**Gary Schwab,** *Valley Forge Capital Management*

I'd just like to say congratulations, great quarter. Have you been surprised -- following up on Dick's question on aftermarket- have you been surprised by how strong the aftermarket sales have been in the past year?

**Dan Thoren:** To some level. Now, I don't have a lot of history with the company, so I couldn't tell you what it was like 10 and 15 years ago. But we do know that - especially in the U.S., where the majority of our aftermarket comes from - that these refineries have been running hard. And so, they've got to continue to invest in them and keep them properly serviced, to be able to keep that high level of output going. And so, from a demand side, I would say, not too surprising just because we're not adding a bunch of new capacity here in this country, and you got to keep the existing assets running at top performance. So. . .

**Gary Schwab:** Okay. Because it's really picked up a lot in the last year --

**Dan Thoren:** Oh, yes.

**Gary Schwab:** -- and I know you have an aftermarket sales force that you started. What's the -- how have they become so successful in closing orders? Are the orders just there? Or is it the way you're doing it?

**Dan Thoren:** Well, I think it's both. So certainly, the demand is up just because of the refinery output has been so high for a long time. The other part of it, we have been investing in our aftermarket team, adding more engineers, readjusted some of the leadership associated with aftermarket. And I think that's been positive. We're not done yet. As we kind of think about our installed base internationally, we're trying to figure out how to go after that too. And so, we've got initiatives with both of our sales offices to figure out the communication strategies relative to life of components and service intervals and things like that. So, it is -- has been a proactive approach to continue to grow that business. And honestly, I think that we still have quite a bit of room to improve. So, we're encouraged in the aftermarket business that we can keep it going. So, we'll see.

**Gary Schwab:** Is most of it installed base? Or is all of it installed base?

**Dan Thoren:** Yes, pretty much all of it is installed base, yes.

**Gary Schwab:** So, the fact that these are all customers of yours that you've delivered product to before, and you talked last quarter about really not having much visibility. Is there a way that you can increase visibility? Almost like setting up a subscription business for replacement parts based on predicted wear rates or predicted failure dates?

**Dan Thoren:** Yes, we've got -- we've actually got an initiative that's starting this week. We've got a kickoff meeting to figure out how to automate -- using AI is a little bit of a stretch, I would say, but automate our approach to aftermarket that uses this installed base -- installed base database, understanding exactly when these things got installed and the typical life associated with the components and starting to automate our market outreach to those installed base customers. So, again, I said I think that there's quite a bit more we can do. And so, we're not resting on our laurels here. We're out there being aggressive and trying to figure out how to go get more.

**Gary Schwab:** Okay, and just one last question for Chris. Is this worth putting a line item on? You have space sales, chemical sales, refinery sales, defense sales - adding aftermarket sales as a line?

**Chris Thome:** So, certainly something we can think about internally here. It's definitely related to the refining and petrochemical markets. So, it's kind of all encompassing, and our disclosure really is by market, which the aftermarket is related to, if anything else, we'd probably in the future, look to break out new energy because that's becoming a higher growth and more important part of our business.

**Gary Schwab:** Okay, because it is the biggest gross margin product that you carry?

**Chris Thome:** Sure.

**Gary Schwab:** Okay, thanks a lot and congratulations again.

**Operator:** Our next questions come from the line of John Bair with Ascend Wealth Advisors.

**John Bair, Ascend Wealth Advisors, LLC**

Congratulations, Dan and Chris, very good to see -- real pleased to see the debt out of there. And so, I've got 2 questions, quick questions. One is contemplation perhaps within the next year, or 12 months, beyond reinstituting a dividend? And the second question would be, with regards to the aftermarket sales, what percentage or roughly -- what's the breakout between the traditional refining and marketing upgrades versus biodiesel, which you've said has been in the mix here?

**Chris Thome:** Yes, John, so let me take the first one with regards to a dividend. As we've already been talking here on the call, we have quite a bit of CapEx that needs to get spent over the next several years. And we have a lot of organic growth opportunities that are in front of us that are well in excess of 20% ROI. So, those are really our main focus, and then as well as -- we've really started to try to build out the pipeline with regards to M&A as well, and P3 is a great example of the types of opportunities that we'd like to take advantage of. So really, for the next several years, we're going to be focused on organic growth and M&A and paying down any kind of debt that might come with M&A. So, right now, the Board has not made any decision to reinstate that dividend at this point.

**Dan Thoren:** And then your question about aftermarket, traditional versus biodiesel. Certainly, we've seen an uptick in applications using biodiesel where some of these refineries are getting converted over. I would guess -- I don't have that detail as far as what the aftermarket looks like. The installed base is relatively small at this point compared to refineries. So, I would suspect that the aftermarket is relatively small also. But I couldn't quantify that for you, other than small in relationship to the refinery aftermarket.

**John Bair:** And what does that aftermarket look like as far as the international market where you have an established base of past business?

**Dan Thoren:** Very various. . .

**John Bair:** Are they on the same cycle, I guess, is what I'm getting at? Is that a similar situation internationally?

**Dan Thoren:** Internationally, we're seeing new capacity being brought on. So, there's been quite a bit of new capacity in China and India, for instance, and Middle East seems to also be planning on new capacity. And so that continues to grow on the new side. The aftermarket in the installed base internationally has not been a big piece of our business in the past. And as we build that installed base, we have plans to be much more aggressive in going after that. So, as I have said earlier, we've got initiatives in our sales offices internationally to figure out what that installed base is, where it is, and how we go after it in a concerted effort with the Batavia effort here.

**John Bair:** Well, great. Keep up the good work, it's very encouraging. Thank you.

**Operator:** Thank you. We have reached the end of our question-and-answer session. I would now like to turn the floor back over to Dan Thoren for any closing remarks.

**Dan Thoren:** Thank you for joining us today. I hope you can sense the excitement we have here at Graham about our future. We will be participating virtually in two upcoming conferences: the Gabelli Pump, Valve and Water Symposium on February 22, and then the Sidoti Conference on March 14. As always, please feel free to reach out to us at any time and we look forward to talking with you all again after our fourth quarter fiscal 2024 results. Enjoy your day.

**Operator:** And this concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.

*of the call, which is available on the Company's website ([grahamcorp.com](http://grahamcorp.com)), as well as to information available on the SEC's website ([www.sec.gov](http://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.*