GRAHAM CORP
Form 10-K
May 25, 2010

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended March 31, 2010

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission File Number 1-8462

GRAHAM CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	**16-1194720**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
20 Florence Avenue, Batavia, New York	**14020**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code 585-343-2216

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock (Par Value $.10)	**NYSE Amex**

Securities registered pursuant to Section 12(g) of the Act:

Title of Class
Preferred Stock Purchase Rights

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by checkmark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller Reporting company o

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No þ

The aggregate market value of the voting stock held by non-affiliates of the registrant as of September 30, 2009, the last business day of the registrant s most recently completed second fiscal quarter, was $143,920,692. The market value calculation was determined using the closing price of the registrant s common stock on September 30, 2009, as reported on the NYSE Amex exchange. For purposes of the foregoing calculation only, all directors, officers and the Employee Stock Ownership Plan of the registrant have been deemed affiliates.

As of May 21, 2010, the registrant had outstanding 9,850,277 shares of common stock, $.10 par value, and 9,850,277 preferred stock purchase rights.

Documents Incorporated By Reference

Portions of the registrant s definitive Proxy Statement, to be filed in connection with the registrant s 2010 Annual Meeting of Stockholders to be held on July 29, 2010, are incorporated by reference into Part III, Items 10, 11, 12, 13 and 14 of this filing.

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GRAHAM CORPORATION
Annual Report on Form 10-K
Year Ended March 31, 2010

Note: Portions of the registrant s definitive Proxy Statement, to be issued in connection with the registrant s 2010 Annual Meeting of Stockholders to be held on July 29, 2010, are incorporated by reference into Part III, Items 10, 11, 12, 13 and 14 of this Annual Report on Form 10-K.

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PART I

(Dollar amounts in thousands except per share data).

Item 1. *Business*

Graham Corporation (Graham, the Company, we, us or our) designs, manufactures and sells custom-built vacuu heat transfer equipment to customers worldwide. Our products include steam jet ejector vacuum systems, surface condensers for steam turbines, vacuum pumps and compressors, various types of heat exchangers, including helical coil heat exchangers marketed under the Heliflow® name, and plate and frame heat exchangers. Our products produce a vacuum, condense steam or transfer heat, or perform a combination of these tasks. Our products are available in a variety of metals and non-metallic corrosion resistant materials.

Our products are used in a wide range of industrial process applications, including:

- petroleum refineries;
- chemical and petrochemical plants;
- fertilizer plants;
- power generation facilities, such as fossil fuel, nuclear, cogeneration and geothermal power plants;
- alternative energy;
- pharmaceutical plants;
- plastics plants;
- liquefied natural gas production facilities;
- soap manufacturing plants;
- air conditioning systems;
- propulsion systems for nuclear aircraft carriers;
- food processing plants; and
- other process industries.

Our Customers and Markets

Our principal customers are in the chemical, petrochemical, petroleum refining and power generating industries, and can be end users of our products in their manufacturing, refining and power generation processes, large engineering companies that build installations for companies in such industries, and/or the original equipment manufacturers, who combine our products with their equipment prior to its sale to end users.

Our products are sold by a team of sales engineers we employ directly and independent sales representatives located worldwide. No part of our business is dependent on a single customer or a few customers, the loss of which would seriously harm our business, or on contracts or subcontracts that are subject to renegotiation or termination by a governmental agency.

Historically, 40% to 50% percent of our revenue has been generated from foreign sales, and we believe that revenue from the sale of our products outside the U.S. will continue to account for a significant portion of our total revenue for the foreseeable future. We have invested significant resources in developing and maintaining our international sales operations and presence, and we intend to continue to make such investments in the future. As a result of the expansion of our presence in Asia, we expect that the Asian market will over time account for an increasing percentage of our revenue. We expect international sales to account for 50% to 60% or more of total revenue over the next few years.

A breakdown of our net sales by geographic area and product class for our fiscal years ended March 31, 2010, 2009 and 2008, which we refer to as fiscal 2010, fiscal 2009 and fiscal 2008, respectively, is contained in Note 12 to

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our consolidated financial statements included in Item 8 of Part II of this Annual Report on Form 10-K. Our backlog at March 31, 2010 was $94,255 compared with $48,290 at March 31, 2009.

We were incorporated in Delaware in 1983 and are the successor to Graham Manufacturing Co., Inc., which was incorporated in New York in 1936. Our principal business location is in Batavia, New York. We also maintain a wholly-owned subsidiary, Graham Vacuum and Heat Transfer Technology (Suzhou) Co., Ltd., located in Suzhou, China. As of March 31, 2010, we had 237 full-time employees.

Our Strengths

Our core strengths include the following:

We have strong brand recognition. Over the past 74 years, we believe that we have built a reputation for top quality, reliable products and high standards of customer service. We have also established a large installed application base. As a result, the Graham name is well known not only by our existing customers, but also by many of our potential customers. We believe that the recognition of the Graham brand allows us to capitalize on market opportunities in both existing and potential markets.

We custom engineer and manufacture high quality products and systems that address the particular needs of our customers. With 74 years of engineering expertise, we believe that we are well respected for our knowledge in vacuum and heat transfer technologies. We maintain strict quality control and manufacturing standards in order to manufacture products of the highest quality.

We have a global presence. Our products are used worldwide, and we have sales representatives located in many countries throughout the world.

We have a strong reputation. We believe that we have a solid reputation and strong relationships with our existing customer base, as well as with our key suppliers.

We have a strong balance sheet. We maintain significant cash and investments on hand, and no bank debt. Our defined benefit pension plan obligations are fully funded.

We have a high quality credit facility. Our credit facility provides us with a $30,000 borrowing capacity.

Our Strategy

Our objective is to capture more market share within the geographies and industries we serve, expand our geographic markets, grow our presence in the energy industry and continually improve our results of operations. Our strategy to accomplish our objective is:

Capitalize on the strength of the Graham brand in order to win more business in our traditional markets and enter other markets.

Identify and consummate acquisition and organic growth opportunities where we believe our brand strength will provide us with the ability to expand and complement our core business. This includes extending our existing product lines, moving into complementary product lines and expanding our global sales presence in order to further broaden our existing markets and reach additional markets.

Invest in people and capital equipment to meet the long-term growth in demand for our products in the oil refining, petrochemical processing and power generating industries, especially in emerging markets. Specifically, we intend to strengthen our sales and engineering in Asia and establish manufacturing capabilities where long-term estimates of demand for oil and oil by-products point to continued growth.

Deliver highest quality products and solutions that enable our customers to achieve their operating objectives and that differentiate us from our competitors, and which allow us to win new orders based on value.

In order to effectively implement our strategy, we also believe that we must continually work to improve our Company. These efforts include:

Investing in engineering resources and technology in order to advance our vacuum and heat transfer technology market penetration.

Enhancing our engineering and manufacturing capacities, especially in connection with the design of our products, in order to more quickly respond to existing and future customer demand and to minimize underutilization of capacity.

Accelerating our bids on available contracts by implementing front-end bid automation and design processes.

Expanding our margins by implementing and expanding upon our operational efficiencies through a flexible manufacturing flow model and other cost efficiencies.

Continued focus and success on production error elimination and rework reduction.

Competition

Our business is highly competitive. The principal bases on which we compete include technology, price, performance, reputation, delivery, and quality. Our competitors in our primary markets include:

NORTH AMERICA

Market	Competitors
Refining vacuum distillation	Gardner Denver, Inc.
Chemicals/Petrochemicals	Croll Reynolds Company, Inc.; Schutte Koerting; Gardner Denver, Inc.
Turbomachinery Original Equipment Manufacturer (OEM) refining, petrochemical	Ambassador; KEMCO; Yuba Heat Transfer, LLC
Turbomachinery OEM power and power producer	Holtec; Thermal Engineering International (USA), Inc.; KEMCO; Yuba Heat Transfer, LLC
HVAC	Alfa Laval AB; APV; ITT; Ambassador

INTERNATIONAL

Market	Competitors
Refining vacuum distillation	Gardner Denver, Inc.; GEA Wiegand GmbH; Edwards, Ltd.; Korting Hannover AG
Chemicals/Petrochemicals	Croll Reynolds Company, Inc.; Schutte Koerting; Gardner Denver, Inc.; GEA Wiegand GmbH; Korting Hannover AG; Edwards, Ltd.
Turbomachinery OEM refining, petrochemical	DongHwa Entec Co., Ltd.; Bumwoo Engineering Co., Ltd.; Oeltechnik GmbH; KEMCO
Turbomachinery OEM power and power producer	Holtec; Thermal Engineering International; KEMCO; Yuba Heat Transfer, LLC

Intellectual Property

Our success depends in part on our proprietary technology. We rely on a combination of patent, copyright, trademark, trade secret laws and confidentiality provisions to establish and protect our proprietary rights. We also depend heavily on the brand recognition of the Graham name in the marketplace.

Availability of Raw Materials

Although shortages of certain materials can from time to time affect our ability to meet delivery requirements for certain orders, historically, we have not been materially adversely impacted by the availability of raw materials.

Working Capital Practices

Our business does not require us to carry significant amounts of inventory or materials beyond what is needed for work in process. We do not provide rights to return goods, or payment terms to customers that we consider to be extended in the context of the industries we serve.

Environmental Matters

We believe that we are in material compliance with existing environmental laws and regulations. We do not anticipate that our compliance with federal, state and local laws regulating the discharge of material in the environment or otherwise pertaining to the protection of the environment will have a material effect upon our capital expenditures, earnings or competitive position.

Seasonality

No material part of our business is seasonal in nature. However, our business is highly cyclical in nature as it depends on the willingness of our customers to invest in major capital projects.

Research and Development Activities

During fiscal 2010, fiscal 2009 and fiscal 2008, we spent \$3,824, \$3,347 and \$3,579, respectively, on research and development activities related to new products and services, or the improvement of existing products and services.

Information Regarding International Sales

The sale of our products outside the U.S. has accounted for a significant portion of our total revenue during our last three fiscal years. Approximately 55%, 37% and 46% of our revenue in fiscal 2010, fiscal 2009 and fiscal 2008, respectively, resulted from foreign sales. Sales in Asia constituted approximately 33%, 13% and 15% of our revenue in fiscal 2010, fiscal 2009 and fiscal 2008, respectively. Sales in the Middle East constituted approximately 10%, 8% and 11% of our revenue in fiscal 2010, fiscal 2009 and fiscal 2008, respectively. Our foreign sales and operations are subject to numerous risks, as more particularly discussed under the heading Risk Factors in Item 1A of Part I of this Annual Report on Form 10-K.

Available Information

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended. Therefore, we file periodic reports, proxy statements and other information with the Securities and Exchange Commission (the SEC). The SEC maintains an Internet website (located at www.sec.gov) that contains reports, proxy statements and other information for registrants that file electronically. Additionally, such reports may be read and copied at the Public Reference Room of the SEC at 100 F Street NE, Washington, D.C. 20549. Information regarding the SEC s Public Reference Room can be obtained by calling 1-800-SEC-0330.

We maintain an Internet website located at www.graham-mfg.com. On our website, we provide a link to the SEC s Internet website that contains the reports, proxy statements and other information we file electronically. We do not provide this information on our website because it is more cost effective for us to provide a link to the SEC s website. Copies of all documents we file with the SEC are available in print to any stockholder who makes a request. Such requests should be made to our Corporate Secretary at our corporate headquarters. The other information found on our website is not part of this or any other report we file with, or furnish to, the SEC.

Item 1A. ***Risk Factors***

Our business and operations are subject to numerous risks, many of which are described below and elsewhere in this Annual Report on Form 10-K. If any of the events described below or elsewhere in this Annual Report on Form 10-K occur, our business and results of operations could be harmed. Additional risks and uncertainties that are not presently known to us, or which we currently deem to be immaterial, could also harm our business and results of operations.

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Risks related to our business

The industries in which we operate are cyclical, and downturns in such industries may adversely affect our operating results.

Historically, a substantial portion of our revenue has been derived from the sale of our products to companies in the chemical, petrochemical, petroleum refining and power generating industries, or to firms that design and construct facilities for these industries. The core industries in which our products are used are, to varying degrees, cyclical and have historically experienced severe downturns. Although we believe there will be a long-term expansion of demand for our products in the petrochemical, petroleum refining and power generating industries, during fiscal 2009, we entered a sudden downturn in the demand for our products and services. Historically, previous cyclical downturns have lasted from one to several years. We have no way to predict or control the length or severity of the current downturn. A longer than normal or deeper down cycle could force us to reduce our infrastructure, which would make it difficult for us to quickly recover in the subsequent up cycle. This scenario would require us to rebuild our business and be slower to gain market share back. A sustained deterioration in any of the cyclical industries we serve would materially harm our business and operating results because our customers would not likely have the resources necessary to purchase our products nor would they likely have the need to build additional facilities or improve existing facilities.

We serve markets that are capital intensive. The recent volatility and disruption of the capital and credit markets and adverse changes in the global economy may negatively impact our operating results. Such volatility and disruption may also negatively impact our ability to access additional financing.

Although we believe that the fundamentals that have driven our growth over the past several years remain essentially unchanged and that our long-term growth prospects remain strong, we also expect that the state of the capital and credit markets has caused a slow-down in spending by our customers as they evaluate the current and future economic impact of such crisis to their project plans. If adverse economic and credit conditions persist or worsen, we would likely experience decreased revenue from our operations attributable to decreases in the spending levels of our customers. Adverse economic and credit conditions might also have a negative adverse effect on our cash flows if customers demand that we accept smaller project deposits and less frequent progress payments. In addition, adverse economic and credit conditions could put downward pricing pressure on us. If any of the foregoing occurs, there would be an adverse effect on our results of operations.

Moreover, the state of the capital and credit markets could have an adverse effect on our ability to obtain additional financing on commercially reasonable terms, if at all, should we determine such financing is desirable to expand our business.

The larger markets we serve are the petroleum refining and petrochemical industries which are both cyclical in nature and dependent on the price of oil. As a result, volatility in the price of crude oil may negatively impact our operating results.

Although we believe that the global consumption of crude oil will increase over the course of the next twenty years and a need to continually increase global oil refining capacity, the price of crude oil has been very volatile. Many of our products are purchased in connection with oil refinery construction, revamps and upgrades. During times of significant volatility in the market for crude oil, our customers may refrain from placing orders until the market stabilizes. During such times of high volatility, we could experience decreased revenue from our operations attributable to decreases in the spending levels of our customers.

A large percentage of our sales are in non-U.S. jurisdictions. As a result, we are subject to the economic, political, regulatory and other risks of international operations.

For fiscal 2010, approximately 55% of our revenue was from customers located in countries outside of the U.S. We believe that revenue from the sale of our products outside the U.S. will continue to account for a significant portion of our revenue for the foreseeable future. Moreover, we maintain a subsidiary and have facilities in China. We believe that revenue from the sale of our products outside the U.S. will continue to account for a significant portion of our total revenue for the foreseeable future. We intend to continue to expand our international operations

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to the extent that suitable opportunities become available. Our foreign operations and sales could be adversely affected as a result of:

- nationalization of private enterprises and assets;
- political or economic instability in certain countries, especially during the ongoing global economic crisis;
- differences in foreign laws, including increased difficulties in protecting intellectual property and uncertainty in enforcement of contract rights;
- the possibility that foreign governments may adopt regulations or take other actions that could directly or indirectly harm our business and growth strategy;
- credit risks;
- currency fluctuations;
- tariff and tax increases;
- export and import restrictions and restrictive regulations of foreign governments;
- shipping products during times of crisis or wars;
- our failure to comply with U.S. laws regarding doing business in foreign jurisdictions, such as the Foreign Corrupt Practices Act; and
- other factors inherent in foreign operations.

We are subject to foreign currency fluctuations which may adversely affect our operating results.

We are exposed to the risk of currency fluctuations between the U.S. dollar and the currencies of the countries in which we sell our products to the extent that such sales are not based on U.S. dollars. As such, fluctuations in currency exchange rates, which cause the value of the U.S. dollar to increase, could have an adverse effect on the profitability of our business. While we may enter into currency exchange rate hedges from time to time to mitigate these types of fluctuations, we cannot remove all fluctuations or hedge all exposures and our earnings are impacted by changes in currency exchange rates. In addition, if the counter-parties to such exchange contracts do not fulfill their obligations to deliver the contractual foreign currencies, we could be at risk for fluctuations, if any, required to settle the obligation. At March 31, 2010, we held no forward foreign currency exchange contracts.

If we fail to introduce enhancements to our existing products or to keep abreast of technological changes in our markets, our business and results of operations could be adversely affected.

Although technologies in the vacuum and heat transfer areas are well established, we believe our future success depends, in part, on our ability to enhance our existing products and develop new products in order to continue to meet customer demands. Our failure to introduce new or enhanced products on a timely and cost-competitive basis, or the development of processes that make our existing technologies or products obsolete, could harm our business and results of operations.

The loss of any member of our management team and our inability to make up for such loss with a qualified replacement could harm our business.

Competition for qualified management in our industry is intense. Many of the companies with which we compete for management personnel have greater financial and other resources than we do or are located in geographic areas which may be considered by some to be more desirable places to live. If we are not able to retain any of our key management personnel, our business could be harmed.

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Our business is highly competitive. If we are unable to successfully implement our business strategy, we risk losing market share to current and future competitors.

Some of our present and potential competitors may have substantially greater financial, marketing, technical or manufacturing resources. Our competitors may also be able to respond more quickly to new technologies or processes and changes in customer demands. They may also be able to devote greater resources towards the development, promotion and sale of their products than we can. In addition, our current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties that increase their ability to address the needs of our customers. In addition, customer buying patterns can change if customers become more price sensitive and accepting of low cost suppliers. If we cannot compete successfully against current or future competitors, our business will be harmed.

If we are unable to make necessary capital investments or respond to pricing pressures, our business may be harmed.

In order to remain competitive, we need to invest continuously in research and development, manufacturing, customer service and support, and marketing. From time to time we also have to adjust the prices of our products to remain competitive. We may not have available sufficient financial or other resources to continue to make investments necessary to maintain our competitive position.

If third parties infringe upon our intellectual property or if we were to infringe upon the intellectual property of third parties, we may expend significant resources enforcing or defending our rights or suffer competitive injury.

Our success depends in part on our proprietary technology. We rely on a combination of patent, copyright, trademark, trade secret laws and confidentiality provisions to establish and protect our proprietary rights. If we fail to successfully enforce our intellectual property rights, our competitive position could suffer. We may also be required to spend significant resources to monitor and police our intellectual property rights. Similarly, if we were to infringe on the intellectual property rights of others, our competitive position could suffer. Furthermore, other companies may develop technologies that are similar or superior to our technologies, duplicate or reverse engineer our technologies or design around our patents.

In some instances, litigation may be necessary to enforce our intellectual property rights and protect our proprietary information, or to defend against claims by third parties that our products infringe their intellectual property rights. Any litigation or claims brought by or against us, whether with or without merit, could result in substantial costs to us and divert the attention of our management, which could harm our business and results of operations. In addition, any intellectual property litigation or claims against us could result in the loss or compromise of our intellectual property and proprietary rights, subject us to significant liabilities, require us to seek licenses on unfavorable terms, prevent us from manufacturing or selling certain products or require us to redesign certain products, any of which could harm our business and results of operations.

We are subject to contract cancellations and delays by our customers, which may adversely affect our operating results.

Contract cancellations may occur, which could reduce the realizable value of our backlog and negatively impact the amount of revenue earned and the profitability of our business. Certain contracts in backlog may contain provisions allowing for the assessment of cancellation charges to our customers to substantially compensate us for costs incurred on cancelled contracts. Delay of contract execution by our customers can result in volatility in our operating results.

A decrease in supply or increase in cost of the materials used in our products could harm our profitability.

Any restrictions on the supply or the increase in the cost of the materials used by us in manufacturing our products could significantly reduce our profit margins, which could harm our results of operations. Any efforts we may engage in to mitigate restrictions on the supply or price increases of materials by entering into long-term purchase agreements, by implementing productivity improvements or by passing cost increases on to our customers may not be successful. Our profitability depends largely on the price and continuity of supply of the materials used in the manufacture of our products, which in many instances are supplied by a limited number of sources.

If we are unable to effectively outsource a portion of our production during times when we are experiencing strong demand, our results of operations might be adversely affected. In addition, outsourcing may negatively affect our profit margins.

When we experience strong demand for our products, our business strategy calls for us to increase manufacturing capacity through outsourcing selected fabrication processes. We could experience difficulty in outsourcing if customers demand that our products be manufactured by us exclusively. Furthermore, our ability to effectively outsource production could be adversely affected by worldwide manufacturing capacity. If we are unable to effectively outsource our production capacity when circumstances warrant, our results of operations could be adversely affected and we might not be able to deliver products to our customers on a timely basis. In addition, outsourcing to complete our products and services can increase the costs associated with such products and services. If we rely too heavily on outsourcing and are not able to increase our own production capacity during times when there is high demand for our products and services, our margins may be negatively effected.

We face potential liability from asbestos exposure and similar claims.

We are a defendant in several lawsuits alleging illnesses from exposure to asbestos or asbestos-containing products and seeking unspecified compensatory and punitive damages. We cannot predict with certainty the outcome of these lawsuits or whether we could become subject to any similar, related or additional lawsuits in the future. In addition, because some of our products are used in systems that handle toxic or hazardous substances, any failure or alleged failure of our products in the future could result in litigation against us. Any litigation brought against us, whether with or without merit, could result in substantial costs to us as well as divert the attention of our management, which could harm our business and results of operations.

If we become subject to product liability claims, our results of operations and financial condition could be adversely affected.

The manufacturing and sale of our products exposes us to potential product liability claims, including those that may arise from failure to meet product specifications, misuse or malfunction of, or design flaws in our products, or use of our products with systems not manufactured or sold by us. For example, our equipment is installed in facilities that operate dangerous processes and the misapplication, improper installation or failure of our equipment may result in exposure to potentially hazardous substances, personal injury or property damage.

Provisions contained in our contracts with customers which attempt to limit our damages may not be enforceable in all instances or may fail to protect us from liability for damages. In addition, we carry liability insurance that we believe is adequate to protect us from product liability claims, however, our insurance may not cover all liabilities. We may not be able to maintain this insurance at a reasonable cost or on reasonable terms, or at all. Any material liability not covered by provisions in our contracts or by insurance could have a material adverse effect on our results of operations, financial condition and cash flows.

Risks related to operating a subsidiary in China

The operations of our Chinese subsidiary may be adversely affected by China s evolving economic, political and social conditions.

We conduct our business in China primarily through our wholly-owned Chinese subsidiary. The results of operations and future prospects of our Chinese subsidiary are subject to evolving economic, political and social developments in China. In particular, the results of operations of our Chinese subsidiary may be adversely affected by, among other things, changes in China s political, economic and social conditions, changes in policies of the Chinese government, changes in laws and regulations or in the interpretation of existing laws and regulations, changes in foreign exchange regulations, measures that may be introduced to control inflation, such as interest rate increases, and changes in the rates or methods of taxation.

Intellectual property rights are difficult to enforce in China.

Chinese commercial law is relatively undeveloped compared with the commercial law in many of our other major markets and limited protection of intellectual property is available in China as a practical matter. Although we take precautions in the operations of our Chinese subsidiary to protect our intellectual property, any local design or manufacture of products that we undertake in China could subject us to an increased risk that unauthorized parties will be able to copy or otherwise obtain or use our intellectual property, which could harm our business. We may also have limited legal recourse in the event we encounter patent or trademark infringers.

Uncertainties with respect to the Chinese legal system may adversely affect the operations of our Chinese subsidiary.

Our Chinese subsidiary is subject to laws and regulations applicable to foreign investment in China. There are uncertainties regarding the interpretation and enforcement of laws, rules and policies in China. The Chinese legal system is based on written statutes, and prior court decisions have limited precedential value. Because many laws and regulations are relatively new and the Chinese legal system is still evolving, the interpretations of many laws, regulations and rules are not always uniform. Moreover, the relative inexperience of China s judiciary in many cases creates additional uncertainty as to the outcome of any litigation, and the interpretation of statutes and regulations may be subject to government policies reflecting domestic political changes. Finally, enforcement of existing laws or contracts based on existing law may be uncertain and sporadic. For the preceding reasons, it may be difficult for us to obtain swift and equitable enforcement of laws ostensibly designed to protect companies like ours.

Risks related to the ownership of our common stock

Provisions contained in our certificate of incorporation, bylaws and our stockholder rights plan could impair or delay stockholders ability to change our management and could discourage takeover transactions that our stockholders might consider to be in their best interests.

Provisions of our certificate of incorporation and bylaws, as well as our stockholder rights plan, could impede attempts by our stockholders to remove or replace our management and could discourage others from initiating a potential merger, takeover or other change of control transaction, including a potential transaction at a premium over the market price of our common stock, that our stockholders might consider to be in their best interests. For example:

> *We could issue shares of preferred stock with terms adverse to our common stock*. Under our certificate of incorporation, our Board of Directors is authorized to issue shares of preferred stock and to determine the rights, preferences and privileges of such shares without obtaining any further approval from the holders of our common stock. We could issue shares of preferred stock with voting and conversion rights that adversely affect the voting power of the holders of our common stock, or that have the effect of delaying or preventing a change in control of our company.
>
> *We maintain a stockholder rights, or poison pill, plan*. Our stockholder rights plan has the effect of discouraging any person or group that wishes to acquire 15% or more of our common stock from doing so without obtaining our agreement because such acquisition would cause such person or group to suffer substantial dilution. Such plan may have the effect of discouraging a change in control transaction that our stockholders would otherwise consider to be in their best interests. This plan expires on September 11, 2010.
>
> *Only a minority of our directors may be elected in a given year*. Our bylaws provide for a classified Board of Directors, with only approximately one-third of our Board elected each year. This provision makes it more difficult to effect a change of control because at least two annual stockholder meetings are necessary to replace

a majority of our directors.

Our bylaws contain advance notice requirements. Our bylaws also provide that any stockholder who wishes to bring business before an annual meeting of our stockholders or to nominate candidates for election as directors at an annual meeting of our stockholders must deliver advance notice of their proposals to us before the meeting. Such advance notice provisions may have the effect of making it more difficult to introduce business at stockholder meetings or nominate candidates for election as director.

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Our certificate of incorporation requires supermajority voting to approve a change of control transaction. Seventy-five percent of our outstanding shares entitled to vote are required to approve any merger, consolidation, sale of all or substantially all of our assets and similar transactions if the other party to such transaction owns 5% or more of our shares entitled to vote. In addition, a majority of the shares entitled to vote not owned by such 5% or greater stockholder are also required to approve any such transaction.

Amendments to our certificate of incorporation require supermajority voting. Our certificate of incorporation contains provisions that make its amendment require the affirmative vote of both 75% of our outstanding shares entitled to vote and a majority of the shares entitled to vote not owned by any person who may hold 50% or more of our shares unless the proposed amendment was previously recommended to our stockholders by an affirmative vote of 75% of our Board. This provision makes it more difficult to implement a change to our certificate of incorporation that stockholders might otherwise consider to be in their best interests without approval of our Board.

Amendments to our bylaws require supermajority voting. Although our Board of Directors is permitted to amend our bylaws at any time, our stockholders may only amend our bylaws upon the affirmative vote of both 75% of our outstanding shares entitled to vote and a majority of the shares entitled to vote not owned by any person who owns 50% or more of our shares. This provision makes it more difficult for our stockholders to implement a change they may consider to be in their best interests without approval of our Board.

Item 1B. *Unresolved Staff Comments*

Not applicable.

Item 2. *Properties*

Our corporate headquarters, located at 20 Florence Avenue, Batavia, New York, consists of a 45,000 square foot building. Our management team and substantially all of our engineering and research and development operations are based in our corporate headquarters. Our manufacturing facilities, also located in Batavia, consist of approximately 33 acres and contain about 216,000 square feet in several connected buildings, including 162,000 square feet in manufacturing facilities, 48,000 square feet for warehousing and a 6,000 square-foot building for product research and development.

Additionally, we lease a U.S. sales office in Houston and our Chinese subsidiary leases a sales and engineering office in Suzhou, China.

We believe that our properties are generally in good condition, are well maintained, and are suitable and adequate to carry on our business.

Item 3. *Legal Proceedings*

The information required by this Item 3 is contained in Note 15 to our consolidated financial statements included in Item 8 of Part II of this Annual Report on Form 10-K and is incorporated herein by reference.

Item 4. *(Removed and Reserved)*

PART II

(Amounts in thousands, except per share data)

Item 5. ***Market For Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Our common stock is traded on the NYSE Amex exchange under the symbol GHM . As of May 21, 2010, there were 9,850 shares of our common stock outstanding that were held by approximately 151 stockholders of record.

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The following table shows the high and low per share prices of our common stock for the periods indicated, as reported by the NYSE Amex. The table and the disclosure below takes into account the effect of our two-for-one stock split in the nature of a dividend, which became effective October 6, 2008.

	High	Low
Fiscal year 2010		
First quarter	$ 16.12	$ 8.70
Second quarter	15.67	10.52
Third quarter	21.84	13.37
Fourth quarter	21.58	14.63
Fiscal year 2009		
First quarter	$ 38.25	$ 17.50
Second quarter	54.91	21.25
Third quarter	27.36	6.85
Fourth quarter	13.89	7.16

Subject to the rights of any preferred stock we may then have outstanding, the holders of our common stock are entitled to receive dividends as may be declared from time to time by our Board of Directors out of funds legally available for the payment of dividends. Dividends declared per share by our Board of Directors for each of the four quarters of fiscal 2010 were $.02 and for the first, second, third and fourth quarters of fiscal 2009 were $.015, $.02, $.02 and $.02, respectively. There can be no assurance that we will pay cash dividends in any future period or that the level of cash dividends paid by us will remain constant.

The senior credit facility to which we are a party contains provisions pertaining to the maintenance of a minimum total liabilities to tangible net worth ratio as well as restrictions on the payment of dividends to stockholders and incurrence of additional long-term debt. The facility also limits the payment of dividends to stockholders to $1,200 per year.

On January 29, 2009, our Board of Directors authorized a stock repurchase program, which expired on July 29, 2009. On July 30, 2009, the stock repurchase program was extended by our Board of Directors through July 30, 2010. Under the stock repurchase program, up to 1,000 shares of our common stock are permitted to be repurchased by us from time to time either in the open market or through privately negotiated transactions. The stock repurchase program terminates at the earlier of the expiration of the program on July 30, 2010, when all 1,000 shares have been repurchased or when our Board of Directors terminates the program. Cash on hand has been used to fund all stock repurchases under the program.

Item 6. ***Selected Financial Data***

(For Fiscal Years Ended March 31)	2010	2009	2008(1)	2007(1)	2006(1)
	GRAHAM CORPORATION FIVE YEAR SUMMARY OF SELECTED FINANCIAL DATA (Amounts in thousands, except per share data)				
Operations:					
Net sales	$ 62,189	$ 101,111	$ 86,428	$ 65,822	$ 55,208
Gross profit	22,231	41,712	34,162	16,819	15,959
Gross profit percentage	35.7%	41.3%	39.5%	25.6%	28.9%
Income from continuing operations	6,361	17,467	15,034	5,761	3,586
Dividends	788	754	493	387	367
Common stock:					
Basic earnings from continuing operations per share	$ .64	$ 1.72	$ 1.52	$ .59	$ .39
Diluted earnings from continuing operations per share	.64	1.71	1.49	.58	.38
Stockholders equity per share	7.01	6.21	4.86	3.15	2.83
Dividends declared per share	.08	.075	.05	.04	.04
Market price range of common stock					
High	21.84	54.91	30.48	9.20	10.40
Low	8.70	6.85	6.30	5.02	3.31
Average common shares outstanding diluted	9,937	10,195	10,085	9,850	9,336
Financial data at March 31:					
Cash and cash equivalents and investments	$ 74,590	$ 46,209	$ 36,793	$ 15,051	$ 10,988
Working capital	56,704	49,547	36,998	20,119	16,779
Capital expenditures	1,003	1,492	1,027	1,637	1,048
Depreciation	1,107	977	862	874	775
Total assets	108,979	86,924	70,711	48,878	40,556
Long-term debt, including capital lease obligations	144	31	36	56	30
Stockholders equity	69,074	61,111	48,536	30,654	27,107

(1) Per share data has been adjusted to reflect the following stock splits: a two-for-one stock split declared on July 31, 2008; a five-for-four stock split declared on October 26, 2007; and a two-for-one stock split declared on July 28, 2005.

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Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

(Amounts in thousands, except per share data)

Overview

We are a global designer and manufacturer of custom-engineered ejectors, vacuum systems, condensers, liquid ring pump packages and heat exchangers. Our equipment is used in critical applications in the petrochemical, oil refinery and electric power generation industries, including cogeneration and geothermal plants. Our equipment can also be found in alternative energy applications, including ethanol, biodiesel and coal and gas-to-liquids and other applications, and other diverse applications, such as metal refining, pulp and paper processing, shipbuilding, water heating, refrigeration, desalination, soap manufacturing, food processing, pharmaceuticals, heating, ventilating and air conditioning.

Our corporate offices and production facilities are located in Batavia, New York. We also have a wholly-owned foreign subsidiary located in Suzhou, China which supports sales orders from China and provides engineering support and supervision of subcontracted fabrication.

Highlights

Highlights for our fiscal year ended March 31, 2010, which we refer to as fiscal 2010, include:

Net income and income per diluted share for fiscal 2010, were $6,361 and $0.64 compared with net income and income per diluted share of $17,467 and $1.71 for fiscal year ended March 31, 2009, which we refer to as fiscal 2009.

Net sales for fiscal 2010 of $62,189 were down 38% compared with $101,111 for fiscal 2009.

Orders placed in fiscal 2010 of $108,317 were up 47% compared with fiscal 2009, when orders were $73,874. Fiscal 2010 orders set a record high.

Backlog on March 31, 2010 of $94,255 was up 95% from backlog of $48,290 on March 31, 2009. Backlog on March 31, 2010 set a record high.

Gross profit and operating margins for fiscal 2010 were 35.7% and 16.2% compared with 41.3% and 26.0%, respectively, for fiscal 2009.

Cash and short-term investments at March 31, 2010 were $74,590 compared with $46,209 as of March 31, 2009, up 61%. Cash and investments on hand at March 31, 2010 set a record high. Our cash and short-term investments position includes a significant increase in customer advances, as certain key customers negotiated these pre-payments to lower project costs.

At fiscal year end, we had a solid balance sheet that was free of bank debt and that provided financial flexibility.

Forward-Looking Statements

This report and other documents we file with the Securities and Exchange Commission include forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the

Securities Exchange Act of 1934, as amended.

These statements involve known and unknown risks, uncertainties and other factors that may cause actual results to be materially different from any future results implied by the forward-looking statements. Such factors include, but are not limited to, the risks and uncertainties identified by us under the heading Risk Factors in Item 1A of our Annual Report on Form 10-K. Forward-looking statements may also include, but are not limited to, statements about:

- the current and future economic environments affecting us and the markets we serve;
- sources of revenue and anticipated revenue, including the contribution from the growth of new products, services and markets;

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plans for future products and services and for enhancements to existing products and services;

our operations in foreign countries;

estimates regarding our liquidity and capital requirements;

timing of conversion of backlog to sales;

our ability to attract or retain customers;

the outcome of any existing or future litigation;

our acquisition strategy; and

our ability to increase our productivity and capacity.

Forward-looking statements are usually accompanied by words such as anticipate, believe, estimate, may, intend, expect and similar expressions. Actual results could differ materially from historical results or those implied by the forward-looking statements contained in this report.

Undue reliance should not be placed on our forward-looking statements. Except as required by law, we undertake no obligation to update or announce any revisions to forward-looking statements contained in this Annual Report on Form 10-K, whether as a result of new information, future events or otherwise.

Fiscal 2011 and the Near-Term Market Conditions

The downturn in the global economy which commenced in the fall of 2007 led to reduced demand for petroleum-based products, which in turn led our customers to defer investment in major capital projects. We believe that we are beginning to see some positive signs that international customers are once again examining investments in major capital projects.

In addition, we believe that the significant increase in construction costs, including raw material costs, which had occurred over the four-to-five-year period prior to the recent downturn, also led to delays in new commitments by our customers. The increase in costs resulted in the economics of projects becoming less feasible, which we believe caused our customers to choose to wait until costs declined, as they have recently.

Currently, near-term demand trends that we believe are affecting our customers investments include:

As the world recovers slowly from the global recession, many emerging economies continue to have relatively strong economic growth. This expansion is driving growing energy requirements and the need for more refined petroleum products. Although uncertainty in the capital markets continues, there has been some improved access to capital, which has resulted in certain previously stalled projects being released.

The expansion of the Middle Eastern economies and the continued growth in demand for oil and refined products has renewed investment activity in that area. We believe that such renewed activity is exemplified by the re-starting of projects in both the petrochemical and refining industries, such as the Jubail and Yanbu export refinery projects in Saudi Arabia (as construction costs for these projects have reportedly been reduced by 20%).

Asia, specifically China, has been experiencing renewed demand for refined petroleum products such as gasoline in calendar year 2009 and thus far in 2010, following reductions in demand during calendar year 2008 as economic uncertainty stymied growth. This renewed demand is driving increased investment in petrochemical and refining projects.

South America, specifically Brazil, Venezuela and Colombia, is seeing increased refining and petrochemical investments that are driven by their continually expanding economies and increased local demand for gasoline and other products that are made from oil as the feedstock.

The U.S. refining market has declined and refinery utilization has fallen as demand declined from conservation efforts, economic weakness, and uncertainty around U.S. energy policy and its potential impact on production costs. As a result, there have been fewer investment dollars in capital projects for refineries in the U.S. This is expected to continue for the next few years.

Investments in North American oil sands have been delayed as a result of construction costs and uncertainty around U.S. energy policy (and the potential impact that changes to the energy policy may have on production costs which has impacted project economics and risk). Recently however, there have been investments in extraction projects in Alberta and foreign investment in Alberta which suggest that downstream investments that involve our equipment might increase in the next two to three years.

We expect that the consequences of these near-term trends will be more pressure on our gross margins, as the U.S. refining market has historically provided higher margins than certain international markets. Because of continued global economic uncertainty and the risk associated with growth in emerging economies, we also expect that we will have continued volatility in our order pattern. For the next several quarters, we expect to see smaller value projects than what we had seen during the last expansion cycle. This will require more orders for us to achieve a similar revenue level.

We continue to expect our new order levels to remain volatile, resulting in both strong and weak quarters. For example, sequentially the past four quarters had new order levels of $8,838, $29,567, $51,644, and $18,268, in the first, second, third and fourth quarters of fiscal 2010, respectively. We believe that looking at our order level in any one quarter does not provide an accurate indication of our future expectations or performance. Rather, we believe that looking at our orders and backlog over a rolling four-quarter time period provides a better measure of our business.

Shift Back to International Growth Expected to Drive Next Industry Cycle

Over the long-term, we expect our customers markets to regain their strength and, while remaining cyclical, continue to grow. We believe the long-term trends remain strong and that the drivers of future growth include:

Demand Trends

Global consumption of crude oil is estimated to expand significantly over the next two decades, primarily in emerging markets. This is expected to offset estimated flat to slightly declining demand in North America and Europe.

Increased demand is expected for power, refinery and petrochemical products, stimulated by an expanding middle class in Asia.

Increased development of geothermal electrical power plants in certain regions is expected to meet projected growth in demand for electrical power.

Increased global regulations over the refining and petrochemical industries are expected to continue to drive requirements for capital investments.

Increased demand is expected from the nuclear power generation industry and government contractors.

Impact of Demand Trends

Construction of new petrochemical plants in the Middle East, where natural gas is plentiful and less expensive, is expected to continue.

Increased investments in new power projects are expected in Asia and South America to meet projected consumer demand increases.

Global oil refining capacity is projected to increase, and is expected to be addressed through new facilities, refinery upgrades, revamps and expansions.

Long-term growth potential is believed to exist in alternative energy markets, such as coal-to-liquids, gas-to-liquids and other emerging technologies, such as biodiesel, ethanol and waste-to-energy.

We believe that all of the above factors offer us long-term growth opportunity to meet our customers expected capital project needs. In addition, we believe we can continue to grow our less cyclical smaller product lines and aftermarket businesses.

Emerging markets require petroleum-based products. These markets are expected to continue to grow at rates faster than the U.S. Therefore, we expect international opportunities will be more plentiful relative to domestic projects. Our domestic sales as a percentage of aggregate product sales, which had increased over the prior three fiscal years from 50% in fiscal 2007 to 54% in fiscal 2008 to 63% in fiscal 2009, decreased to 45% in fiscal 2010. The economic recovery, which we believe has partly begun in the international markets, will likely provide greater opportunities than the domestic market in the near term. Our order rates for fiscal 2010 were 50% domestic and 50% international. However, the domestic order level was heavily impacted by a large order (in excess of $25,000) from Northrop Grumman to supply surface condensers for the U.S. Navy. If we exclude this project, the international order percentage would have exceeded 65%. As we look at fiscal 2011 and beyond, we believe international sales over the next few years will likely surpass domestic sales.

Results of Operations

For an understanding of the significant factors that influenced our performance, the following discussion should be read in conjunction with our consolidated financial statements and the notes to our consolidated financial statements included in this Annual Report on Form 10-K.

The following table summarizes our results of operations for the periods indicated:

	Year Ended March 31,		
	2010	**2009**	**2008**
Net sales	$ 62,189	$ 101,111	$ 86,428
Net income	$ 6,361	$ 17,467	$ 15,034
Diluted income per share	$ 0.64	$ 1.71	$ 1.49
Total assets	$ 108,979	$ 86,924	$ 70,711

Fiscal 2010 Compared with Fiscal 2009

Sales for fiscal 2010 were $62,189, a 38% decrease, as compared with sales of $101,111 for fiscal 2009. The decrease was due to reduced demand for petroleum-based products as a result of the economic downturn which caused our customers to defer investment in major capital projects. This decline in sales occurred in all product lines. International sales accounted for 55% of all sales for fiscal 2010, which were up from 37% in fiscal 2009. Domestic sales decreased by $35,793 in fiscal 2010. International sales declined $3,129 in fiscal 2010, driven by sales declines in Canada, South America, Middle East and Europe, somewhat offset by higher sales in Asia and Africa. Sales for fiscal 2010 were 41% to the refining industry (down from 46% in fiscal 2009), 35% to the chemical and petrochemical industries (up from 27%) and 24% to other industrial applications (down from 27%), including electrical power.

Our gross profit percentage for fiscal 2010 was 35.7% compared with 41.3% for fiscal 2009. Gross profit dollars for fiscal 2010 decreased 47%, or $19,481, compared with fiscal 2009. Gross profit dollars decreased due to lower volume, which resulted in the significant under utilization of our production capacity. The lower volume and utilization declines were partly offset by improved raw material purchasing benefits especially in the first and second quarter of fiscal 2010, and continued improvements in productivity.

Selling, general and administrative, or SG&A, and other expenses for fiscal 2010 were $12,189, down 21% compared with $15,384 in fiscal 2009. Included in fiscal 2009 costs was a pre-tax charge of $559 for restructuring costs. SG&A and other expenses as a percentage of sales increased in fiscal 2010 to 19.6% of sales compared with 15.2% of sales in fiscal 2009. SG&A expenses decreased due to lower variable costs (e.g., sales commissions, compensation, headcount expenses) related to lower sales and cost controls in place throughout fiscal 2010.

Interest income for fiscal 2010 was $55, down from $416 in fiscal 2009. This decrease was due to lower rates of return on our investments, which are primarily short-term U.S. Treasury securities.

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Interest expense was $36 in fiscal 2010, up from $5 in fiscal 2009. The increase was due to an interest charge of $32 for unrecognized tax benefits, as discussed below, taken in fiscal 2010.

Our effective tax rate in fiscal 2010 was 37% compared with an effective tax rate of 35% for fiscal 2009. The increase was due to a charge for unrecognized tax benefits of $445 related to research and development tax credits taken in tax years 2006 through 2010. Such charge is management s estimate of our potential exposure related to an ongoing Internal Revenue Service examination of our research and development tax credits. We believe our tax position is correct and we intend to continue to vigorously defend our position. Associated with the tax charge was an interest charge of $32, as noted in the above paragraph, and a $10 tax credit, related to the interest charge. The combination of these charges and credit was a net charge to earnings of $467 ($435 in taxes and $32 in interest), which lowered our earnings per share in fiscal 2010 by $0.05 per share. Excluding the tax charge, our effective tax rate in fiscal 2010 was 32.5%. The total tax benefit related to the research and development tax credit that is under review by the IRS was $2,218 at March 31, 2010. In assessing the realizability of deferred tax assets, management determined that a portion of the deferred tax assets related to certain state investment tax credits and net operating losses will not be realized and a valuation allowance of $332 was recorded resulting in an increase in the effective tax rate.

Net income for fiscal 2010 and fiscal 2009 was $6,361 and $17,467, respectively. Income per diluted share was $0.64 and $1.71 for the respective periods.

Fiscal 2009 Compared with Fiscal 2008

Sales for fiscal 2009 were $101,111, a 17% increase, as compared with sales of $86,428 for the fiscal year ended March 31, 2008, which we refer to as fiscal 2008. This growth in sales came from all product lines: 32% of the gain came from pumps, 29% from spare parts, and the remaining 39% from condensers, ejectors and heat exchangers. International sales accounted for 37% of all sales for fiscal 2009, which was down from 46% in fiscal 2008. The strength of the U.S. refining market during fiscal 2009 was primarily responsible for such shift. Domestic sales grew $16,838 in fiscal 2009. International sales declined by 5% in fiscal 2009, driven by sales declines in South America and the Middle East due to a slowdown in investment in new capacity. Sales for fiscal 2009 were 46% to the refining industry (up from 43% in fiscal 2008), 27% to the chemical and petrochemical industries (down from 31%) and 27% to other industrial applications (up from 26%), including electrical power.

Our gross profit percentage for fiscal 2009 was 41.3% compared with 39.5% for fiscal 2008. Gross profit dollars for fiscal 2009 increased 22%, or $7,550, compared with fiscal 2008. Gross profit dollars increased due to increased volume, improved product mix achieved by increased selectivity on orders accepted, and improved engineering and manufacturing efficiencies. Our improved operating efficiencies, which were a continuation of the gains we saw in fiscal 2008, enabled us to achieve greater sales volume in fiscal 2009 without spending significant capital (or increasing other fixed costs) to increase our manufacturing capacity.

SG&A expenses for fiscal 2009 remained similar to the fiscal 2008 level of 15%. Actual costs in fiscal 2009 increased $1,751, or 13%, compared with fiscal 2008. SG&A expenses increased due to greater variable costs (e.g., sales commissions, variable compensation) related to higher sales and net income.

During fiscal 2009, as we entered the economic downturn, we restructured our workforce, eliminating certain management, office and manufacturing positions. The restructuring resulted in a pre-tax charge to earnings of $559. This cost was reported as Other Expense. Our on-going annual cost savings as a result of the restructuring is expected to be approximately $2,700.

Interest income for fiscal 2009 was $416, down from $1,026 in fiscal 2008. This decrease was due to lower rates of return on our investments, which are primarily short-term U.S. Treasury securities.

Interest expense was $5 in fiscal 2009, down from $10 in fiscal 2008.

Our effective tax rate in fiscal 2009 was 35%, compared with an effective tax rate of 32% for fiscal 2008. The increase was due to a higher level of pre-tax income relative to our allowable level of tax deductions.

Net income for fiscal 2009 and fiscal 2008 was $17,467 and $15,034, respectively. Income per diluted share was $1.71 and $1.49 for the respective periods.

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Stockholders   Equity

The following discussion should be read in conjunction with our consolidated statements of changes in stockholders equity that can be found in Item 8 of Part II of this Annual Report on Form 10-K. The following table shows the balance of stockholders   equity on the dates indicated:

March 31, 2010	March 31, 2009	March 31, 2008
$ 69,074	$ 61,111	$ 48,536

Fiscal 2010 Compared with Fiscal 2009

Stockholders   equity increased $7,963 or 13%, at March 31, 2010 compared with March 31, 2009. This increase was primarily due to net income and an increase in the value of pension assets. Dividends paid in fiscal 2010 increased 5%, to $788, due to a dividend increase which occurred in early fiscal 2009. We repurchased 26 shares in the first quarter of fiscal 2010 (and a total of 303 shares, including repurchases completed in the fourth quarter of fiscal 2009) pursuant to our publicly announced stock repurchase program. The number of shares remaining that have been approved for repurchase under the stock repurchase program is 697.

On March 31, 2010, our net book value was $7.01 up 13% over March 31, 2009.

Fiscal 2009 Compared with Fiscal 2008

Stockholders   equity increased $12,575 or 26%, at March 31, 2009 compared with March 31, 2008. This increase was primarily due to net income, offset by a decline in the value of pension assets. In July 2008, we increased our dividend per share from 6 cents per share per year to 8 cents per year. Dividends paid in fiscal 2009 increased 53%, or $261, due to the above mentioned increase as well as an increase in mid-fiscal 2008. In fiscal 2009, we increased authorized shares from 6,000 to 25,500. In October 2008, we split our stock 2-for-1 in the form of a stock dividend, increasing the actual outstanding shares to 10,125 shares. We subsequently repurchased 277 shares in the fourth quarter of fiscal 2009 pursuant to our publicly announced stock repurchase program.

On March 31, 2009, our net book value was $6.21 up 28% over March 31, 2008.

Liquidity and Capital Resources

The following discussion should be read in conjunction with our consolidated statements of cash flows and consolidated balance sheets appearing in Item 8 of Part II of this Annual Report on Form 10-K:

	March 31,	
	2010	2009
Working capital(1)	$ 56,704	$ 49,547
Working capital ratio(1)	2.6	3.1
Long-term debt (capital leases)	$ 144	$ 31
Long-term debt/capitalization(2)	0.0%	0.0%
Long-term liabilities/capitalization(3)	7.1%	4.3%

(1) Working capital equals current assets minus current liabilities. Working capital ratio equals current assets divided by current liabilities.

(2) Long-term debt/capitalization equals long-term debt divided by stockholders equity plus long-term debt.

(3) Long-term liabilities/capitalization equals total liabilities minus current liabilities divided by stockholders equity plus long-term debt.

We use the ratios described above to measure our liquidity and overall financial strength.

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As of March 31, 2010, our contractual and commercial obligations for the next five fiscal years ending March 31 and thereafter were as follows:

	Payments Due by Period				
	Total	Less Than 1 Year	1 – 3 Years	3 – 5 Years	Thereafter
Capital lease obligations	$ 219	$ 70	$ 82	$ 67	$
Operating leases(1)	264	158	106		
Pension and postretirement benefits(2)	109	109			
Accrued compensation	292				292
Accrued pension liability	272	26	52	52	142
Other long-term liabilities	445		445		
Total	$ 1,601	$ 363	$ 685	$ 119	$ 434

(1) For additional information, see Note 5 to the consolidated financial statements in Item 8 of Part II of this Annual Report on Form 10-K.

(2) Amounts represent anticipated contributions during fiscal 2010 to our postretirement medical benefit plan, which provides healthcare benefits for eligible retirees and eligible survivors of retirees. On February 4, 2003, we terminated postretirement healthcare benefits for our U.S. employees. Benefits payable to retirees of record on April 1, 2003 remained unchanged. We expect to be required to make cash contributions in connection with these plans beyond one year, but such amounts cannot be estimated. No contributions are expected to be made to our defined benefit pension plan for our fiscal year ending March 31, 2011.

Net cash provided by operating activities for fiscal 2010 was $30,270, compared with $11,046 for fiscal 2009. The largest single component was an increase in customer deposits of $16,130; in fiscal 2009, customer deposits decreased by $100. The increase in customer deposits resulted from major customers providing upfront negotiated cash payments to assist in lowering the cost for Graham to complete their projects. This cash will be utilized to procure materials for these customers projects in the fiscal years ended March 31, 2011 and 2012. We refer to the fiscal years ending March 31, 2011 and 2012 as fiscal 2011 and fiscal 2012, respectively. We often obtain progress payments for large projects from our customers throughout the procurement and manufacturing process. In the recent instances, more cash was provided shortly after the order was secured. During fiscal 2011, we expect operating cash flow will be negative as the customer deposits balance is utilized to procure materials to support production.

The other major contributors to operating cash generation were net income, $6,361 and a reduction in unbilled revenue, $7,407.

Compared with fiscal 2009, net income in fiscal 2010 was lower by $11,106 and the impact of deferred taxes and taxes payable was ($446) in fiscal 2010 compared with cash generation of $3,470 in fiscal 2009. Offsetting these reductions in cash generation, were cash gains of $7,407 in unbilled revenue in fiscal 2010 compared with a cash usage of $1,675 in fiscal 2009 and lower cash usage for pension, $245 in fiscal 2010 compared with $7,677 in fiscal 2009 (primarily due to $7,500 in contribution to the defined benefit pension plan in fiscal 2009).

Cash and cash investments were $74,590 on March 31, 2010 compared with $46,209 on March 31, 2009, up 61%. The largest component of the improvement was an increase in customer deposits of $16,130, to $22,022 on March 31, 2010 compared with $5,892 on March 31, 2009. Cash and cash investments, net of the customer deposits, as discussed above, was $52,568 compared with $40,317.

We invest net cash generated from operations in excess of cash held for near-term needs in U.S. government instruments, generally with maturity periods of up to 180 days. Investments at March 31, 2010 and March 31, 2009 were $70,060 and $41,059, respectively.

Other sources of cash for fiscal 2010 included the issuance of common stock to cover stock options exercised, which raised $63, as compared with $695 in fiscal 2009. In fiscal 2010, we recognized a $40 increase in capital in excess of par value for the income tax benefit realized upon exercise of stock options in excess of the tax benefit amount recognized pertaining to the fair value of stock option awards treated as compensation expense. This amount compared with $1,696 for fiscal 2009.

Other significant uses of cash for fiscal 2010 included our publicly announced stock repurchase program. Under this program, 26 shares of stock were purchased during the first quarter of fiscal 2010 at a cost of $229 (representing an average price of $8.91 per share). This compared with 277 shares purchased in fiscal 2009 at a total cost of $2,288 (representing an average price of $8.25 per share). Dividend payments of $788 and capital expenditures of $1,003 were made in fiscal 2010, compared with $754 and $1,492, respectively, for fiscal 2009. In fiscal 2010, we repaid $39 in excess of amounts borrowed for bank borrowings and capitalized leases, as compared with $28 for fiscal 2009.

Capital expenditures in fiscal 2010 were 86% for plant machinery and equipment and 14% for all other items. Sixty-eight percent of our capital spending was for productivity improvements and the balance was primarily for capitalized maintenance. Capital expenditures for fiscal 2011 are expected to be approximately $3,300. In excess of 40% of our planned fiscal 2011 capital expenditures are related to the Northrop Grumman project for the U.S. Navy won in fiscal 2010. Over 80% of our fiscal 2011 capital expenditures are expected to be for machinery and equipment, with the remaining amounts to be used for information technology and other items.

Our revolving credit facility with Bank of America, N.A. provides us with a line of credit of $30,000, including letters of credit and bank guarantees. Borrowings under our credit facility are secured by all of our assets. Letters of credit outstanding under our credit facility on March 31, 2010 and 2009 were $9,584 and $8,759, respectively. There were no other amounts outstanding on our credit facility at March 31, 2010 and 2009. Our borrowing rate as of March 31, 2009 was Bank of America s prime rate minus 125 basis points, or 2.00%. Availability under the line of credit was $20,416 at March 31, 2010. We believe that cash generated from operations, combined with our investments and available financing capacity under our credit facility, will be adequate to meet our cash needs for the immediate future.

Orders and Backlog

Orders during fiscal 2010 and fiscal 2009 were $108,317 and $73,874, respectively, representing a 47% increase for fiscal 2010 and a record high. Orders represent communications received from customers requesting us to supply products and services. Revenue is recognized on orders received in accordance with our revenue recognition policy included in Note 1 to the consolidated financial statements contained in Item 8 of Part II of this Annual Report on Form 10-K.

Domestic orders were 50%, or $54,273, of our total orders and international orders were 50%, or $54,044, of our total orders in fiscal 2010. Domestic orders grew by $22,860, or 73%, primarily due to a larger order (in excess of $25,000) from Northrop Grumman to provide surface condensers for the U.S. Navy. International orders grew by $11,583, or 27%, led by renewed refining investment in the Middle East. Middle East orders were up $16,415, or 194%, compared with fiscal 2009. Orders from other international regions were down $4,832, with decreases in Asia, Africa and Canada partly offset by gains in South America.

Backlog was a record $94,255 at March 31, 2010 compared with $48,290 at March 31, 2009, a 95% increase. Backlog is defined by us as the total dollar value of orders received for which revenue has not yet been recognized. During fiscal 2010, we were notified by customers that one project with a value of $519 was cancelled, one order with a value of $3,298 was placed on hold (suspended) pending further evaluation, and one project placed on hold (suspended) in fiscal 2009 valued at $235 was returned to active status. Our backlog has been reduced for the cancelled projects, but continues to include orders placed on hold (suspended) with an aggregate value of $6,655 (see Project Cancellation and Project Continuation Risk in Item 7A of Part II of this Annual Report on Form 10-K). All orders in backlog represent orders from our traditional markets in established product lines. Approximately 40% to 50% of orders currently in backlog are not expected to be converted to sales within the next twelve months. At March 31, 2010, approximately 37% of our backlog was attributed to equipment for refinery project work, 15% for chemical and petrochemical projects, and 48% for other industrial or commercial applications (including the Northrop Grumman order for the U.S. Navy). At March 31, 2009, approximately 38% of our backlog was for refinery project work, 35% for chemical and petrochemical projects, and 27% for other industrial or commercial applications.

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In May 2010, one order for $1,588, which had been placed on hold by our customer in fiscal 2009, was cancelled. This order was included in the balance of total placed on hold (suspended) orders that remained in backlog at March 31, 2010. Production had started on this project prior to being put on hold. The customer has requested shipment of the partly completed product as is. This order will be removed from the balance of on hold (suspended) orders during the first quarter of fiscal 2011.

Outlook

We believe that we are currently experiencing the bottom of the cycle associated with our sales to the refinery and petrochemical markets since we tend to lag the general economic cycle by twelve to eighteen months. The third and fourth quarters of fiscal 2010 and the first and second quarter of fiscal 2011 are expected to represent the trough in level sales for our business in this down cycle. Sales were $12,166 and $13,777 in the third and fourth quarter of fiscal 2010, respectively. We expect the first and second quarter of fiscal 2011 to be in a similar range with some potential for upside improvement in the second quarter. We anticipate that sales in the third and fourth quarters of fiscal 2011 will see growth compared with the first and second quarters of fiscal 2011. We expect the gross profit margin percentage to be in the mid-to-upper 20 s range for the first two quarters of fiscal 2011 as we continue to have under utilized capacity. Moreover, orders won 6 to 12 months ago that are now planned for revenue in the first and second quarters have depressed margins due to the competitive environment at that time.

Our order activity was strong in fiscal 2010 and our backlog on March 31, 2010 was $94,255. We expect fiscal 2011 order levels to continue to be variable across the year, as we have seen in the past eight sequential quarters. We do not believe that our markets have fully recovered, and while we have seen some improvements in the Middle