GRAHAM CORP
Form 10-Q
October 28, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

or

¨ 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)

585-343-2216

(Registrant s telephone number, including area code)

Indicate by check mark 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 x No ¨

Indicate by check mark 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 x No ¨

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.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer (Do not check if a smaller reporting company)	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of October 25, 2013, there were outstanding 10,058,568 shares of the registrant s common stock, par value $.10 per share.

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Graham Corporation and Subsidiaries

Index to Form 10-Q

As of September 30, 2013 and March 31, 2013 and for the Three and Six-Month Periods

Ended September 30, 2013 and 2012

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GRAHAM CORPORATION AND SUBSIDIARIES

FORM 10-Q

September 30, 2013

PART I - FINANCIAL INFORMATION

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Item 1. Unaudited Condensed Consolidated Financial Statements

GRAHAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2013	2012	2013	2012
	(Amounts in thousands, except per share data)			
Net sales	$ 24,490	$ 25,902	$ 52,746	$ 48,435
Cost of products sold	16,201	17,989	34,442	34,286
Gross profit	8,289	7,913	18,304	14,149
Other expenses and income:				
Selling, general and administrative	4,393	4,379	8,739	8,407
Selling, general and administrative - amortization	56	57	113	113
Interest income	(10)	(14)	(21)	(25)
Interest expense	4	(370)	9	(290)
Total other expenses and income	4,443	4,052	8,840	8,205
Income before provision for income taxes	3,846	3,861	9,464	5,944
Provision for income taxes	1,257	1,246	3,067	1,939
Net income	2,589	2,615	6,397	4,005
Retained earnings at beginning of period	88,139	75,573	84,632	74,383
Dividends	(302)	(199)	(603)	(399)
Retained earnings at end of period	$ 90,426	$ 77,989	$ 90,426	$ 77,989
Per share data:				
Basic:				
Net income	$.26	$.26	$.64	$.40
Diluted:				
Net income	$.26	$.26	$.63	$.40

Weighted average common shares outstanding:				
Basic:	10,062	10,031	10,060	10,017
Diluted:	10,104	10,054	10,095	10,041
Dividends declared per share	$.03	$.02	$.06	$.04

See Notes to Condensed Consolidated Financial Statements.

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GRAHAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2013	2012	2013	2012
	(Amounts in thousands)			
Net income	$2,589	$2,615	$6,397	$4,005
Other comprehensive income:				
Foreign currency translation adjustment	38	3	45	(12)
Defined benefit pension and other postretirement plans net of income tax of $78 and $78 for the three months ended September 30, 2013 and 2012, respectively, and $156 and $157 for the six months ended September 30, 2013 and 2012, respectively	143	144	286	287
Total other comprehensive income	181	147	331	275
Total comprehensive income	$2,770	$2,762	$6,728	$4,280

See Notes to Condensed Consolidated Financial Statements.

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GRAHAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2013	March 31, 2013
	(Amounts in thousands, except per share data)	
Assets		
Current assets:		
Cash and cash equivalents	$22,862	$24,194
Investments	31,999	27,498
Trade accounts receivable, net of allowances ($39 and $33 at September 30 and March 31, 2013, respectively)	13,946	9,440
Unbilled revenue	9,510	13,113
Inventories	11,222	11,171
Prepaid expenses and other current assets	1,226	783
Income taxes receivable	2,067	2,635
Deferred income tax asset	87	69
Total current assets	92,919	88,903
Property, plant and equipment, net	13,239	13,288
Prepaid pension asset	2,745	2,349
Goodwill	6,938	6,938
Permits	10,300	10,300
Other intangible assets, net	4,698	4,788
Other assets	11	167
Total assets	$130,850	$126,733
Liabilities and stockholders equity		
Current liabilities:		
Current portion of capital lease obligations	$85	$87
Accounts payable	7,563	9,429
Accrued compensation	5,141	5,018
Accrued expenses and other current liabilities	2,906	3,051
Customer deposits	5,662	6,919
Deferred income tax liability	378	373
Total current liabilities	21,735	24,877
Capital lease obligations	85	127
Accrued compensation	315	308
Deferred income tax liability	7,374	7,131
Accrued pension liability	250	227
Accrued postretirement benefits	939	923
Other long-term liabilities	149	145
Total liabilities	30,847	33,738

Commitments and contingencies (Note 11)		
Stockholders equity:		
Preferred stock, $1.00 par value -		
Authorized, 500 shares		
Common stock, $.10 par value -		
Authorized, 25,500 shares		
Issued, 10,376 and 10,331 shares at September 30 and March 31, 2013, respectively	1,038	1,033
Capital in excess of par value	19,398	18,596
Retained earnings	90,426	84,632
Accumulated other comprehensive loss	(7,702)	(8,033)
Treasury stock, 317 and 327 shares at September 30 and March 31, 2013, respectively	(3,157)	(3,233)
Total stockholders equity	100,003	92,995
Total liabilities and stockholders equity	$130,850	$126,733

See Notes to Condensed Consolidated Financial Statements.

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GRAHAM CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended September 30, 2013	Six Months Ended September 30, 2012
	(Amounts in thousands)	
Operating activities:		
Net income	$ 6,397	$ 4,005
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	986	927
Amortization	113	113
Amortization of unrecognized prior service cost and actuarial losses	442	444
Discount accretion on investments	(4)	(6)
Stock-based compensation expense	342	319
Loss on disposal of property, plant and equipment	-	(1)
Deferred income taxes	220	(58)
(Increase) decrease in operating assets:		
Accounts receivable	(4,596)	40
Unbilled revenue	3,640	2,909
Inventories	139	(3,623)
Prepaid expenses and other current and non-current assets	(457)	(145)
Prepaid pension asset	(397)	(384)
Increase (decrease) in operating liabilities:		
Accounts payable	(1,938)	2,233
Accrued compensation, accrued expenses and other current and non-current liabilities	135	35
Customer deposits	(1,343)	(1,765)
Income taxes payable/receivable	568	1,186
Long-term portion of accrued compensation, accrued pension liability and accrued postretirement benefits	46	15
Net cash provided by operating activities	4,293	6,244
Investing activities:		
Purchase of property, plant and equipment	(898)	(578)
Proceeds from disposal of property, plant and equipment	-	4
Purchase of investments	(54,997)	(33,494)
Redemption of investments at maturity	50,500	27,500
Net cash used by investing activities	(5,395)	(6,568)

Financing activities:		
Principal repayments on capital lease obligations	(44)	(41)
Issuance of common stock	259	14
Dividends paid	(603)	(399)
Excess tax benefit (deficiency) on stock awards	119	(5)
Net cash used by financing activities	(269)	(431)
Effect of exchange rate changes on cash	39	(11)
Net decrease in cash and cash equivalents	(1,332)	(766)
Cash and cash equivalents at beginning of period	24,194	25,189
Cash and cash equivalents at end of period	$ 22,862	$ 24,423

See Notes to Condensed Consolidated Financial Statements.

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GRAHAM CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in thousands, except per share data)

NOTE 1 BASIS OF PRESENTATION:

Graham Corporation s (the Company s) Condensed Consolidated Financial Statements include (i) its wholly-owned foreign subsidiary located in China and (ii) its wholly-owned domestic subsidiary located in Lapeer, Michigan. The Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP) for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, each as promulgated by the Securities and Exchange Commission. The Company s Condensed Consolidated Financial Statements do not include all information and notes required by GAAP for complete financial statements. The unaudited Condensed Consolidated Balance Sheet as of March 31, 2013 presented herein was derived from the Company s audited Consolidated Balance Sheet as of March 31, 2013. For additional information, please refer to the consolidated financial statements and notes included in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2013 (fiscal 2013). In the opinion of management, all adjustments, including normal recurring accruals considered necessary for a fair presentation, have been included in the Company s Condensed Consolidated Financial Statements.

The Company s results of operations and cash flows for the three and six months ended September 30, 2013 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2014 (fiscal 2014).

NOTE 2 REVENUE RECOGNITION:

The Company recognizes revenue on all contracts with a planned manufacturing process in excess of four weeks (which approximates 575 direct labor hours) using the percentage-of-completion method. The majority of the Company s revenue is recognized under this methodology. The percentage-of-completion method is determined by comparing actual labor incurred to a specific date to management s estimate of the total labor to be incurred on each contract. Contracts in progress are reviewed monthly, and sales and earnings are adjusted in current accounting periods based on revisions in the contract value and estimated costs at completion. Losses on contracts are recognized immediately when evident. There is no reserve for credit losses related to unbilled revenue recorded for contracts accounted for on the percentage-of-completion method. Any reserve for credit losses related to unbilled revenue is recorded as a reduction to revenue.

Revenue on contracts not accounted for using the percentage-of-completion method is recognized utilizing the completed contract method. The majority of the Company s contracts (as opposed to revenue) have a planned manufacturing process of less than four weeks and the results reported under this method do not vary materially from the percentage-of-completion method. The Company recognizes revenue and all related costs on these contracts upon substantial completion or shipment to the customer. Substantial completion is consistently defined as at least 95% complete with regard to direct labor hours. Customer acceptance is generally required throughout the construction process and the Company has no further material obligations under its contracts after the revenue is recognized.

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NOTE 3 INVESTMENTS:

Investments consist solely of fixed-income debt securities issued by the U.S. Treasury with original maturities of greater than three months and less than one year. All investments are classified as held-to-maturity, as the Company has the intent and ability to hold the securities to maturity. The investments are stated at amortized cost which approximates fair value. All investments held by the Company at September 30, 2013 are scheduled to mature on or before January 9, 2014.

NOTE 4 INVENTORIES:

Inventories are stated at the lower of cost or market, using the average cost method. For contracts accounted for on the completed contract method, progress payments received are netted against inventory to the extent the payment is less than the inventory balance relating to the applicable contract. Progress payments that are in excess of the corresponding inventory balance are presented as customer deposits in the Condensed Consolidated Balance Sheets. Unbilled revenue in the Condensed Consolidated Balance Sheets represents revenue recognized that has not been billed to customers on contracts accounted for on the percentage-of-completion method. For contracts accounted for on the percentage of completion method, progress payments are netted against unbilled revenue to the extent the payment is less than the unbilled revenue for the applicable contract. Progress payments exceeding unbilled revenue are netted against inventory to the extent the payment is less than or equal to the inventory balance relating to the applicable contract, and the excess is presented as customer deposits in the Condensed Consolidated Balance Sheets.

Major classifications of inventories are as follows:

	September 30, 2013	March 31, 2013
Raw materials and supplies	$ 2,599	$ 2,865
Work in process	11,838	13,470
Finished products	559	572
	14,996	16,907
Less - progress payments	3,774	5,736
Total	$11,222	$11,171

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NOTE 5 INTANGIBLE ASSETS:

Intangible assets are comprised of the following:

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
At September 30, 2013			
Intangibles subject to amortization:			
Backlog	$ 170	$ 170	$ -
Customer relationships	2,700	502	2,198
	$ 2,870	$ 672	$ 2,198
Intangibles not subject to amortization:			
Permits	$ 10,300	$ -	$ 10,300
Tradename	2,500	-	2,500
	$ 12,800	$ -	$ 12,800
At March 31, 2013			
Intangibles subject to amortization:			
Backlog	$ 170	$ 170	$ -
Customer relationships	2,700	412	2,288
	$ 2,870	$ 582	$ 2,288
Intangibles not subject to amortization:			
Permits	$ 10,300	$ -	$ 10,300
Tradename	2,500	-	2,500
	$ 12,800	$ -	$ 12,800

Intangible assets are amortized on a straight line basis over their estimated useful lives. Intangible amortization expense for each of the three-month periods ended September 30, 2013 and 2012 was $45. Intangible amortization expense for each of the six months ended September 30, 2013 and 2012 was $90. As of September 30, 2013, amortization expense is estimated to be $90 for the remainder of fiscal 2014 and $180 in each of the fiscal years ending March 31, 2015, 2016, 2017 and 2018.

NOTE 6 STOCK-BASED COMPENSATION:

The Amended and Restated 2000 Graham Corporation Incentive Plan to Increase Shareholder Value provides for the issuance of up to 1,375 shares of common stock in connection with grants of incentive stock options, non-qualified stock options, stock awards and performance awards to officers, key employees and outside directors; provided, however, that no more than 250 shares of common stock may be used for awards other than stock options. Stock options may be granted at prices not less than the fair market value at the date of grant and expire no later than ten years after the date of grant.

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There were no stock option awards granted in the three months ended September 30, 2013 and 2012. Stock option awards granted in the six months ended September 30, 2013 and 2012 were 0 and 49, respectively. The stock option awards granted in fiscal 2013 vest 33 ⅓% per year over a three-year term and have a term of ten years from their grant date.

There were no restricted stock awards granted in the three-month periods ended September 30, 2013 and 2012. Restricted stock awards granted in the six-month periods ended September 30, 2013 and 2012 were 32 and 26, respectively. Performance-vested restricted stock awards of 14 and 18 granted to officers in fiscal 2014 and fiscal 2013, respectively, vest 100% on the third anniversary of the grant date, subject to the satisfaction of the performance metrics for the applicable three-year period. Time-vested restricted stock awards of 12 granted to officers and key employees in fiscal 2014 vest 33 ⅓% per year over a three-year period. Time-vested restricted stock awards of 6 and 8 granted to directors in fiscal 2014 and fiscal 2013, respectively, vest 100% on the first anniversary of the grant date.

During the three months ended September 30, 2013 and 2012, the Company recognized stock-based compensation costs related to stock option and restricted stock awards of $134 and $136, respectively. The income tax benefit recognized related to stock-based compensation was $47 and $48 for the three months ended September 30, 2013 and 2012, respectively. During the six months ended September 30, 2013 and 2012, the Company recognized stock-based compensation costs related to stock option and restricted stock awards of $314 and $292, respectively. The income tax benefit recognized related to stock-based compensation was $110 and $103 for the six months ended September 30, 2013 and 2012, respectively.

The Company has an Employee Stock Purchase Plan (the ESPP), which allows eligible employees to purchase shares of the Company s common stock on the last day of a six-month offering period at a purchase price equal to the lesser of 85% of the fair market value of the common stock on either the first day or the last day of the offering period. A total of 200 shares of common stock were authorized for purchase under the ESPP. During the three months ended September 30, 2013 and 2012, the Company recognized stock-based compensation costs of $13 and $11, respectively, related to the ESPP and $4 and $4, respectively, of related tax benefits. During the six months ended September 30, 2013 and 2012, the Company recognized stock-based compensation costs of $28 and $26, respectively, related to the ESPP and $9 and $8, respectively, of related tax benefits.

NOTE 7 INCOME PER SHARE:

Basic income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Common shares outstanding include share equivalent units, which are contingently issuable shares. Diluted income per share is calculated by dividing net income by the weighted average number of common shares outstanding and, when applicable, potential common shares outstanding during the period. A reconciliation of the numerators and denominators of basic and diluted income per share is presented below:

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	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Six Months Ended September 30, 2013	Six Months Ended September 30, 2012
Basic income per share				
Numerator:				
Net income	$ 2,589	$ 2,615	$ 6,397	$ 4,005
Denominator:				
Weighted common shares outstanding	10,051	9,988	10,033	9,975
Share equivalent units (SEUs)	11	43	27	42
Weighted average common shares and SEUs	10,062	10,031	10,060	10,017
Basic income per share	$.26	$.26	$.64	$.40
Diluted income per share				
Numerator:				
Net income	$ 2,589	$ 2,615	$ 6,397	$ 4,005
Denominator:				
Weighted average shares and SEUs outstanding	10,062	10,031	10,060	10,017
Stock options outstanding	42	23	35	24
Weighted average common and potential common shares outstanding	10,104	10,054	10,095	10,041
Diluted income per share	$.26	$.26	$.63	$.40

Options to purchase a total of 2 and 71 shares of common stock were outstanding at September 2013 and 2012, respectively, but were not included in the above computation of diluted income per share given their exercise prices as they would be anti-dilutive upon issuance.

NOTE 8 PRODUCT WARRANTY LIABILITY:

The reconciliation of the changes in the product warranty liability is as follows:

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Six Months Ended September 30, 2013	Six Months Ended September 30, 2012
Balance at beginning of period	$331	$194	$408	$215
Expense (income) for product warranties	78	(3)	58	8
Product warranty claims paid	(110)	(17)	(167)	(49)
Balance at end of period	$299	$174	$299	$174

The income of $3 for product warranties in the three months ended September 30, 2012 resulted from the reversal of provisions made that were no longer required due to lower claims experience.

The product warranty liability is included in the line item Accrued expenses and other current liabilities in the Condensed Consolidated Balance Sheets.

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NOTE 9 - CASH FLOW STATEMENT:

Interest paid was $6 and $52 for the six-month periods ended September 30, 2013 and 2012, respectively. In addition, income taxes paid for the six months ended September 30, 2013 and 2012 were $2,161 and $39, respectively.

During the six months ended September 30, 2013 and 2012, respectively, stock option awards were exercised and restricted stock awards vested. In connection with such stock option exercises and vesting, the related income tax benefit realized exceeded (reduced) the tax benefit that had been recorded pertaining to the compensation cost recognized by $119 and $(5), respectively, for such periods. This excess tax benefit (deficiency) has been separately reported under Financing activities in the Condensed Consolidated Statements of Cash Flows.

At September 30, 2013 and 2012, respectively, there were $38 and $24 of capital purchases that were recorded in accounts payable and are not included in the caption Purchase of property, plant and equipment in the Condensed Consolidated Statements of Cash Flows. In the six months ended September 30, 2013 and 2012, capital expenditures totaling $0 and $11, respectively, were financed through the issuance of capital leases.

NOTE 10 EMPLOYEE BENEFIT PLANS:

The components of pension cost are as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2013	2012	2013	2012
Service cost	$ 144	$ 136	$ 288	$ 272
Interest cost	339	356	679	713
Expected returns on assets	(682)	(685)	(1,364)	(1,369)
Amortization of:				
Unrecognized prior service cost	1	1	2	2
Actuarial loss	251	254	501	506
Net pension cost	$ 53	$ 62	$ 106	$ 124

The Company made no contributions to its defined benefit pension plan during the six months ended September 30, 2013 and does not expect to make any contributions to the plan for the balance of fiscal 2014.

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The components of the postretirement benefit income are as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2013	2012	2013	2012
Service cost	$ -	$ -	$ -	$ -
Interest cost	8	10	16	19
Amortization of prior service benefit	(42)	(42)	(83)	(83)
Amortization of actuarial loss	11	9	22	19
Net postretirement benefit income	$(23)	$(23)	$(45)	$(45)

The Company paid benefits of $2 related to its postretirement benefit plan during the six months ended September 30, 2013. The Company expects to pay benefits of approximately $105 during the balance of fiscal 2014.

NOTE 11 COMMITMENTS AND CONTINGENCIES:

The Company has been named as a defendant in certain lawsuits alleging personal injury from exposure to asbestos allegedly contained in products made by the Company. The Company is a co-defendant with numerous other defendants in these lawsuits and intends to vigorously defend itself against these claims. The claims are similar to previous asbestos suits that named the Company as defendant, which either were dismissed when it was shown that the Company had not supplied products to the plaintiffs places of work or were settled for immaterial amounts.

As of September 30, 2013, the Company was subject to the claims noted above, as well as other legal proceedings and potential claims that have arisen in the ordinary course of business.

Although the outcome of the lawsuits to which the Company is a party cannot be determined and an estimate of the reasonably possible loss or range of loss cannot be made, management does not believe that the outcomes, either individually or in the aggregate, will have a material effect on the Company s results of operations, financial position or cash flows.

NOTE 12 INCOME TAXES:

The Company files federal and state income tax returns in several domestic and international jurisdictions. In most tax jurisdictions, returns are subject to examination by the relevant tax authorities for a number of years after the returns have been filed. During fiscal 2012, the Company reached a resolution with the U.S. Internal Revenue Service (the IRS) with regard to the research and development tax credits claimed during tax years 2006 through 2008. As a result of such resolution, the tax credits claimed during such years were reduced by approximately 40% and interest was assessed on the underpayment of tax. During fiscal 2013, the Company reached a resolution with the IRS that reduced the research and development tax credits claimed during tax years 2009 and 2010 by approximately 30%. In addition, in fiscal 2013, the Company paid all settlement amounts to the IRS for tax years 2006 through 2010.

The liability for unrecognized tax benefits related to research and development tax credits was $134 at each of September 30, 2013 and March 31, 2013. The Company had one additional unrecognized tax benefit of $882 as of March 31, 2012 which was resolved with the IRS during the three months ended June 30, 2012, resulting in a reversal of the liability.

The Company is subject to examination in federal and state tax jurisdictions for tax years 2011 through 2012 and tax years 2008 through 2012, respectively. The Company is subject to examination in the People s Republic of China for tax years 2010 through 2012. It is the Company s policy to recognize any interest related to uncertain tax positions in interest expense and any penalties related to uncertain tax positions in selling, general and administrative expense. During the three and six months ended September 30, 2013, the Company recorded $2 and $4, respectively, for interest related to its uncertain tax positions. During the three months ended September 30, 2012, the Company reversed provisions that had been made in previous periods for interest related to its uncertain tax positions of $387 due to lower interest assessments by the IRS than expected. Including this reversal, the Company recorded $(325) for interest related to its uncertain tax positions during the six months ended September 30, 2012. No penalties related to uncertain tax positions were recorded in the three-month or six-month periods ended September 30, 2013 or 2012.

In September 2013, the IRS issued final regulations affecting costs to acquire, produce, or improve tangible property and re-proposed regulations affecting dispositions of tangible property. The final regulations are effective for taxable years beginning on or after January 1, 2014. The Company has evaluated the final regulations and does not expect the adoption of the regulations to have a material impact on its consolidated financial statements.

NOTE 13 CHANGES IN ACCUMULATED OTHER COMPREHENSIVE LOSS:

The changes in accumulated other comprehensive loss by component for the six months ended September 30, 2013 are as follows:

	Pension and Other Postretirement Benefit Items	Foreign Currency Items	Total
Balance at April 1, 2013	$ (8,443)	$ 410	$ (8,033)
Other comprehensive income before reclassifications	-	45	45
Amounts reclassified from accumulated other comprehensive loss	286	-	286
Net current-period other comprehensive income	286	45	331
Balance at September 30, 2013	$ (8,157)	$ 455	$ (7,702)

The reclassifications out of accumulated other comprehensive loss by component for the three and six months ended September 30, 2013 are as follows:

Details about Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Comprehensive Loss		Affected Line Item in the Condensed Consolidated Statements of Operations and Retained Earnings
	Three Months Ended September 30, 2013	Six Months Ended September 30, 2013	
Pension and other postretirement benefit items:			
Amortization of unrecognized prior service benefit	$ 41	$ 81[1]	
Amortization of actuarial loss	(262)	(523)[1]	
	(221)	(442)	Income before provision for income
	(78)	(156)	Provision for income taxes
	$(143)	$(286)	Net income

[1] These accumulated other comprehensive loss components are included within the computation of net periodic pension and other postretirement benefit costs. See Note 10.

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NOTE 14 ACCOUNTING AND REPORTING CHANGES:

In the normal course of business, management evaluates all new accounting pronouncements issued by the Financial Accounting Standards Board (FASB), the Securities and Exchange Commission, the Emerging Issues Task Force, the American Institute of Certified Public Accountants or any other authoritative accounting body to determine the potential impact they may have on the Company s consolidated financial statements.

In July 2012, the FASB amended its guidance related to periodic testing of indefinite-lived intangible assets for impairment. The amended guidance is intended to reduce cost and complexity by providing an entity with the option to make a qualitative assessment about the likelihood that an indefinite-lived intangible asset is impaired to determine whether it should perform a quantitative impairment test. The guidance also enhances the consistency of impairment testing among long-lived asset categories by permitting an entity to assess qualitative factors to determine whether it is necessary to calculate the asset s fair value when testing an indefinite-lived intangible asset for impairment, which is equivalent to the impairment testing requirements for other long-lived assets. In accordance with the guidance, an entity will have an option not to calculate annually the fair value of an indefinite-lived intangible asset if the entity determines that it is not more-likely-than-not that the asset is impaired. The provisions of the amended guidance are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company will perform its annual impairment testing of indefinite-lived intangible assets pursuant to this guidance during the third quarter of fiscal 2014. The adoption of the amended guidance is not expected to have a material impact on its consolidated financial statements.

In February 2013, the FASB issued guidance related to the disclosure of amounts reclassified out of accumulated other comprehensive income. This guidance adds new disclosure requirements either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income (AOCI) based on its source and the income statement line items affected by the reclassification. This guidance gives companies the flexibility to present the information either in the notes or parenthetically on the face of the financial statements, provided that all of the required information is presented in a single location. This guidance is effective prospectively for annual and interim reporting periods beginning after December 15, 2012. The Company adopted this guidance during the first quarter of fiscal 2014 and such adoption did not have a material impact on the Company s Condensed Consolidated Financial Statements as it only changed the disclosures surrounding AOCI (See Note 13).

Management does not expect any other recently issued accounting pronouncements, which have not already been adopted, to have a material impact on the Company s consolidated financial statements.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

(Dollar amounts in thousands, except per share data)

Overview

We are a global business that designs, manufactures and sells equipment that is critical to the energy industry, which includes the oil refining, petrochemical, cogeneration, nuclear and alternative power markets. With world-renowned engineering expertise in vacuum and heat transfer technology and extensive nuclear code accredited fabrication and specialty machining experience, we design and manufacture custom-engineered ejectors, pumps, surface condensers and vacuum systems as well as supplies and components for utilization both inside the reactor vessel and outside the containment vessel of nuclear power facilities. Our equipment is also used in nuclear propulsion power systems for the defense industry and can be found in other diverse applications such as metal refining, pulp and paper processing, water heating, refrigeration, desalination, food processing, pharmaceutical, heating, ventilating and air conditioning.

Our corporate headquarters is located in Batavia, New York and we have production facilities in both Batavia, New York and at our wholly-owned subsidiary, Energy Steel & Supply Co. (Energy Steel), located in Lapeer, Michigan. We also have a wholly-owned foreign subsidiary, Graham Vacuum and Heat Transfer Technology (Suzhou) Co., Ltd. (GVHTT), located in Suzhou, China, which supports sales orders from China and provides engineering support and supervision of subcontracted fabrication.

Highlights

Highlights for the three and six months ended September 30, 2013 (the fiscal year ending March 31, 2014 is referred to as fiscal 2014) include:

- Net sales for the second quarter of fiscal 2014 were $24,490, a decrease of 5% compared with $25,902 for the second quarter of the fiscal year ended March 31, 2013, referred to as fiscal 2013. Net sales for the first six months of fiscal 2014 were $52,746, up 9% compared with net sales of $48,435 for the first six months of fiscal 2013.

- Net income and income per diluted share for the second quarter of fiscal 2014 were $2,589 and $0.26, compared with net income of $2,615 and income per diluted share of $0.26 for the second quarter of fiscal 2013. Net income and income per diluted share for the first six months of fiscal 2014 were $6,397 and $0.63, respectively, compared with net income of $4,005 and income per diluted share of $0.40 for the first six months of fiscal 2013.

- Orders booked in the second quarter of fiscal 2014 were $48,425, up 89% compared with the second quarter of fiscal 2013, when orders were $25,619. Orders booked in the first six months of fiscal 2014 were $81,208, up 79% compared with the first six months of fiscal 2013, when orders were $45,340.

- Backlog increased to a record high of $114,392 on September 30, 2013, compared with $90,382 on June 30, 2013 and $85,768 on March 31, 2013.

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- Gross profit margin and operating margin for the second quarter of fiscal 2014 were 34% and 16%, compared with 31% and 13%, respectively, for the second quarter of fiscal 2013. Gross profit margin and operating margin for the first six months of fiscal 2014 were 35% and 18% compared with 29% and 12%, respectively, for the first six months of fiscal 2013.

- Cash and cash equivalents and investments at September 30, 2013 were $54,861, compared with $53,192 on June 30, 2013 and $51,692 at March 31, 2013.

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 for fiscal 2013.

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;
- expectations regarding investments in new projects by our customers;
- sources of revenue and anticipated revenue, including the contribution from the growth of new products, services and markets;
- expectations regarding achievement of revenue and profitability expectations;
- plans for future products and services and for enhancements to existing products and services;
- our operations in foreign countries;
- our ability to continue to pursue our acquisition and growth strategy;
- our ability to expand nuclear power work, including into new markets;

- our ability to successfully execute our existing contracts;
- 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; and
- our ability to increase our productivity and capacity.

Forward-looking statements are usually accompanied by words such as anticipate, believe, estimate, may, m intend, interest, appear, expect, suggest, plan, encourage, potential, and similar expressions. Actual res materially from historical results or those implied by the forward-looking statements contained in this report.

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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 report, whether as a result of new information, future events or otherwise.

Current Market Conditions

We have continued to see strong bidding activity during the first half of fiscal 2014. We believe that bidding activity is a leading indicator of the direction and health of our markets. We believe the business environment is continuing to improve and that our customers are becoming more inclined to procure the equipment needed for their projects. This supports our belief that the oil refining, petrochemical and related markets we serve are continuing to move toward a stronger part of the business cycle. The current activity level within our pipeline continues to be more positive than in the past few years.

We believe the following demand trends that are influencing our customers investments include:

- Lower natural gas cost and a significant increase in supply has occurred over the past few years and has been driven by technology advancements in drilling. The dramatic change in natural gas costs and expectation of steady supply in the U.S. has led to a revival in the U.S. petrochemical market and recent movements toward potential major investment. There are numerous projects in planning, initial engineering, or construction phases for the new petrochemical producing facilities, including ethylene, methanol, ammonia and urea facilities. In addition, existing petrochemical facilities are evaluating restarting idled process units or debottlenecking existing operations to increase throughput. We currently have a number of these projects in our pipeline and have begun to add new orders into backlog associated with the North American petrochemical/chemical markets. We historically have had strong market share within U.S. petrochemical facilities. Lower natural gas cost has also made the U.S. production of ethane, which is a by-product of natural gas production, favorably competitive with naphtha, which is a by-product of crude oil refining, as a feedstock for ethylene production. Proposed ethylene capacity expansion