GRAHAM CORP
Form 10-Q
August 03, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 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)

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 þ No o

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 o No o

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

Yes o No þ

As of July 30, 2010, there were outstanding 9,883,565 shares of the registrant s common stock, par value $.10 per share.

Graham Corporation and Subsidiary
Index to Form 10-Q
As of June 30, 2010 and March 31, 2010 and for the Three-Month Periods
Ended June 30, 2010 and 2009

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Item 1. Condensed Consolidated Financial Statements

GRAHAM CORPORATION AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2010	March 31, 2010
	(Amounts in thousands, except per share data)	
Assets		
Current assets:		
Cash and cash equivalents	$ 6,597	$ 4,530
Investments	64,562	70,060
Trade accounts receivable, net of allowances ($9 and $17 at June 30 and March 31, 2010, respectively)	5,950	7,294
Unbilled revenue	5,978	3,039
Inventories	3,746	6,098
Income taxes receivable	313	
Prepaid expenses and other current assets	1,561	651
Total current assets	88,707	91,672
Property, plant and equipment, net	10,030	9,769
Prepaid pension asset	7,529	7,335
Other assets	193	203
Total assets	$ 106,459	$ 108,979
Liabilities and Stockholders Equity		
Current liabilities:		
Current portion of capital lease obligations	$ 61	$ 66
Accounts payable	5,126	6,623
Accrued compensation	2,178	4,010
Accrued expenses and other current liabilities	1,955	2,041
Customer deposits	21,840	22,022
Income taxes payable		68
Deferred income tax liability	139	138
Total current liabilities	31,299	34,968
Capital lease obligations	132	144
Accrued compensation	299	292
Deferred income tax liability	3,152	2,930
Accrued pension liability	243	246
Accrued postretirement benefits	895	880
Other long-term liabilities	483	445
Total liabilities	36,503	39,905

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, 10,188 and 10,155 shares at June 30 and March 31, 2010, respectively		1,019		1,016
Capital in excess of par value		15,602		15,459
Retained earnings		60,219		59,539
Accumulated other comprehensive loss		(4,330)		(4,386)
Treasury stock (305 shares at June 30 and March 31, 2010, respectively)		(2,554)		(2,554)
Total stockholders equity		69,956		69,074
Total liabilities and stockholders equity	$	106,459	$	108,979

See Notes to Condensed Consolidated Financial Statements.

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GRAHAM CORPORATION AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS
(Unaudited)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009
	(Amounts in thousands, except per share data)	
Net sales	$ 13,351	$ 20,138
Cost of products sold	9,501	11,860
Gross profit	3,850	8,278
Other expenses and income:		
Selling, general and administrative	2,567	3,248
Interest income	(16)	(18)
Interest expense	7	1
Total other expenses and income	2,558	3,231
Income before income taxes	1,292	5,047
Provision for income taxes	414	1,529
Net income	878	3,518
Retained earnings at beginning of period	59,539	53,966
Dividends	(198)	(197)
Retained earnings at end of period	$ 60,219	$ 57,287
Per share data:		
Basic:		
Net income	$ .09	$ .36
Diluted:		
Net income	$ .09	$ .35
Weighted average common shares outstanding:		
Basic	9,922	9,885
Diluted	9,962	9,915
Dividends declared per share	$ .02	$ .02

See Notes to Condensed Consolidated Financial Statements.

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GRAHAM CORPORATION AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended June 30,	
	2010	2009
	(Amounts in thousands)	
Operating activities:		
Net income	$ 878	$ 3,518
Adjustments to reconcile net income to net cash used by operating activities:		
Depreciation and amortization	291	250
Amortization of unrecognized prior service cost and actuarial losses	70	170
Discount accretion on investments	(15)	(17)
Stock-based compensation expense	59	78
Gain on disposal or sale of property, plant and equipment		(3)
Deferred income taxes	23	51
(Increase) decrease in operating assets:		
Accounts receivable	1,346	(9,123)
Unbilled revenue	(2,933)	5,368
Inventories	2,354	518
Income taxes receivable/payable	(381)	1,412
Prepaid expenses and other current and non-current assets	(726)	(238)
Prepaid pension asset	(194)	(61)
Increase (decrease) in operating liabilities:		
Accounts payable	(1,526)	421
Accrued compensation, accrued expenses and other current and non-current liabilities	(1,882)	(1,985)
Customer deposits	(183)	(890)
Long-term portion of accrued compensation, accrued pension liability and accrued postretirement benefits	19	13
Net cash used by operating activities	(2,800)	(518)
Investing activities:		
Purchase of property, plant and equipment	(525)	(80)
Proceeds from disposal of property, plant and equipment		7
Purchase of investments	(50,837)	(36,558)
Redemption of investments at maturity	56,350	35,570
Net cash provided (used) by investing activities	4,988	(1,061)
Financing activities:		
Proceeds from issuance of long-term debt		198
Principal repayments on long-term debt	(16)	(204)
Issuance of common stock	66	34
Dividends paid	(198)	(197)
Purchase of treasury stock		(229)

Excess tax deduction on stock awards	22	21
Other		2
Net cash used by financing activities	(126)	(375)
Effect of exchange rate changes on cash	5	1
Net increase (decrease) in cash and cash equivalents	2,067	(1,953)
Cash and cash equivalents at beginning of period	4,530	5,150
Cash and cash equivalents at end of period	$ 6,597	$ 3,197

See Notes to Condensed Consolidated Financial Statements.

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GRAHAM CORPORATION AND SUBSIDIARY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2010 and 2009
(Unaudited)
(Amounts in thousands, except per share data)

NOTE 1 BASIS OF PRESENTATION:

Graham Corporation s (the Company s) Condensed Consolidated Financial Statements include one wholly-owned foreign subsidiary located in China, and have been prepared in accordance with accounting principles generally accepted in the United States (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, 2010 presented herein was derived from the Company s audited Consolidated Balance Sheet as of March 31, 2010. 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, 2010 (fiscal 2010). 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 months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2011 (fiscal 2011).

Certain reclassifications have been made to prior year amounts to conform with the current year presentation. In the Condensed Consolidated Statements of Cash Flows, the line item Amortization of unrecognized prior service cost and actuarial losses was reported separately from the line item Depreciation and amortization for the three months ended June 30, 2009.

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 to management.

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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 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 obligations under the contract after the revenue is recognized.

At March 31, 2010, the Company s backlog included four orders with a value of $6,655 that were placed on hold (suspended) pending further customer evaluation. During the three months ended June 30, 2010, one of the orders placed on hold valued at $1,588 was cancelled. Production had started on this project prior to being put on hold. The customer requested shipment of the partly completed project on an as is basis. At June 30, 2010, three orders included in backlog with a value of $5,211 remained on hold (suspended).

NOTE 3 INVESTMENTS:

Investments consist solely of fixed-income debt securities issued by the United States 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 June 30, 2010 are scheduled to mature between July 1 and September 30, 2010.

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.

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Major classifications of inventories are as follows:

	June 30, 2010	March 31, 2010
Raw materials and supplies	$ 1,879	$ 1,843
Work in process	5,356	5,365
Finished products	581	573
	7,816	7,781
Less progress payments	4,070	1,683
Total	$ 3,746	$ 6,098

NOTE 5 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.

Stock option awards granted in the three months ended June 30, 2010 and 2009 were 20 and 24, respectively. The stock option awards vest 33 % per year over a three-year term. All options have a term of ten years from their grant date.

Restricted stock awards granted in the three months ended June 30, 2010 and 2009 were 24 and 15, respectively. Performance-vested restricted stock awards granted to officers in the three months ended June 30, 2010 vest 100% on the third anniversary of the grant date, subject to the satisfaction of the performance metrics established for the applicable three-year period. Time-vested restricted stock awards granted to officers in the three-month period ended June 30, 2009 vest 50% on the second anniversary of the grant date and 50% on the fourth anniversary of the grant date. Time-vested restricted stock awards granted to directors for the three months end June 30, 2010 and 2009 vest 100% on the first anniversary of the grant date.

During the three months ended June 30, 2010 and 2009, the Company recognized stock-based compensation costs of $59 and $78, respectively. The income tax benefit recognized related to stock-based compensation was $20 and $27 for the three months ended June 30, 2010 and 2009, respectively.

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NOTE 6 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:

	Three Months Ended June 30,	
	2010	2009
Basic income per share		
Numerator:		
Net income	$ 878	$ 3,518
Denominator:		
Weighted common shares outstanding	9,864	9,831
Share equivalent units (SEUs)	58	54
Weighted average common shares and SEUs	9,922	9,885
Basic income per share	$ .09	$ .36
Diluted income per share		
Numerator:		
Net income	$ 878	$ 3,518
Denominator:		
Weighted average shares and SEUs outstanding	9,922	9,885
Stock options outstanding	40	30
Weighted average common and potential common shares outstanding	9,962	9,915
Diluted income per share	$ .09	$ .35

Options to purchase a total of 17 and 41 shares of common stock were outstanding at June 30, 2010 and 2009, 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.

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NOTE 7 PRODUCT WARRANTY LIABILITY:

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

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009
Balance at beginning of period	$ 369	$ 366
Expense (income) for product warranties	30	(52)
Product warranty claims (paid) refunded	(64)	4
Balance at end of period	$ 335	$ 318

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

NOTE 8 CASH FLOW STATEMENT:

Interest paid was $1 for each of the three-month periods ended June 30, 2010 and 2009. In addition, income taxes paid were $715 and $29 for the three months ended June 30, 2010 and 2009, respectively.

During the three months ended June 30, 2010 and 2009, stock option awards were exercised and the related income tax benefit realized exceeded the tax benefit that had been recorded pertaining to the compensation cost recognized. This excess tax deduction has been separately reported under Financing activities in the Condensed Consolidated Statement of Cash Flows.

At June 30, 2010 and 2009, there were $23 and $1 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.

NOTE 9 COMPREHENSIVE INCOME:

Total comprehensive income was as follows:

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009
Net income	$ 878	$ 3,518
Other comprehensive income:		
Foreign currency translation adjustment	10	1
Defined benefit pension and other postretirement plans	46	108
Total comprehensive income	$ 934	$ 3,627

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Defined benefit pension and other postretirement plans reflect the amortization of prior service costs and recognized gains and losses related to such plans during the periods.

NOTE 10 EMPLOYEE BENEFIT PLANS:

The components of pension (benefit) cost are as follows:

	Three Months Ended June 30,	
	2010	2009
Service cost	$ 96	$ 79
Interest cost	335	324
Expected return on assets	(625)	(465)
Amortization of:		
Service cost	1	1
Actuarial loss	105	205
Net pension (benefit) cost	$ (88)	$ 144

The Company made no contributions to its defined benefit pension plan during the three months ended June 30, 2010 and does not expect to make any contributions to the plan for the balance of fiscal 2011.

The components of the postretirement benefit income are as follows:

	Three Months Ended June 30,	
	2010	2009
Service cost	$	$
Interest cost	15	15
Amortization of prior service cost	(41)	(41)
Amortization of actuarial loss	5	5
Net postretirement benefit income	$ (21)	$ (21)

The Company paid benefits of $1 related to its postretirement benefit plan during the three months ended June 30, 2010. The Company expects to pay benefits of approximately $121 for the balance of fiscal 2011.

NOTE 11 COMMITMENTS AND CONTINGENCIES:

The Company has been named as a defendant in certain lawsuits alleging personal injury from exposure to asbestos 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 amounts below the expected defense costs. The outcome of these lawsuits cannot be determined at this time.

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From time to time in the ordinary course of business, the Company is subject to legal proceedings and potential claims. At June 30, 2010, other than noted above, management was unaware of any material litigation matters.

NOTE 12 INCOME TAXES:

The Company files federal and state income tax returns in several domestic and foreign 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. The Company is currently under examination by the United States Internal Revenue Service (the IRS) for tax year 2009. The IRS has completed its examination for tax years 2006 through 2008. In June 2010, the IRS proposed an adjustment, plus interest, to disallow substantially all of the research and development tax credit claimed by the Company in tax years 2006 through 2008. The Company filed a protest to appeal the adjustment in July 2010. The Company believes its tax position is correct and will continue to take appropriate actions to vigorously defend its position.

The cumulative tax benefit related to the research and development tax credit for the tax years ended March 31, 1999 through March 31, 2010 was $2,218. The liability for unrecognized tax benefits related to this tax position was $445 at June 30 and March 31, 2010, which represents management s estimate of the potential resolution of this issue. During the first quarter of fiscal 2011, there was no change in the balance of the unrecognized tax benefit. Any additional impact on the Company s income tax liability cannot be determined at this time. The tax benefit and liability for unrecognized tax benefits were recorded in the Company s Consolidated Statement of Operations as follows:

	Year Ended March 31,				
	2007	2008	2009	2010	Total
Tax benefit of research and development tax credit	$ 1,653	$ 218	$ 238	$ 109	$ 2,218
Unrecognized tax benefit				(445)	(445)
Net tax benefit of research and development tax credit	$ 1,653	$ 218	$ 238	$ (336)	$ 1,773

The Company is subject to examination in state and international tax jurisdictions for tax years 2006 through 2009 and tax year 2009, respectively. 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. The Company had no other unrecognized tax benefits as of June 30, 2010. During the three months ended June 30, 2010 and 2009, the Company recorded $6 and $0, respectively, for interest and $0 for penalties related to its uncertain tax position in each of the three month periods ended June 30, 2010 and 2009.

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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 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

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