

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008.

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

(State or other jurisdiction of
incorporation or organization)

16-1194720

(I.R.S. Employer
Identification No.)

20 Florence Avenue, Batavia, New York

(Address of principal executive offices)

14020

(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 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. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a 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

As of November 3, 2008, there were outstanding 10,125,574 shares of the registrant's common stock, par value \$.10 per share.

Graham Corporation and Subsidiary
Index to Form 10-Q
As of September 30, 2008 and March 31, 2008 and for the Six-Month Periods
Ended September 30, 2008 and 2007

	Page
<u>Part I.</u>	
<u>FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	4
<u>Condensed Consolidated Financial Statements</u>	
<u>Item 1A.</u>	16
<u>Risk Factors</u>	
<u>Item 2.</u>	18
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	
<u>Item 3.</u>	26
<u>Quantitative and Qualitative Disclosure About Market Risk</u>	
<u>Item 4.</u>	26
<u>Controls and Procedures</u>	
<u>Part II.</u>	
<u>OTHER INFORMATION</u>	
<u>Item 4.</u>	28
<u>Submission of Matters to a Vote of Security Holders</u>	
<u>Item 5.</u>	29
<u>Other Information</u>	
<u>Item 6.</u>	29
<u>Exhibits</u>	
<u>Signatures</u>	30
<u>Index to Exhibits</u>	31

GRAHAM CORPORATION AND SUBSIDIARY
FORM 10-Q
SEPTEMBER 30, 2008

PART I — FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

GRAHAM CORPORATION AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	September 30, 2008	March 31, 2008
(Amounts in thousands, except per share data)		
Assets		
Current assets:		
Cash and cash equivalents	\$ 5,044	\$ 2,112
Investments	37,811	34,681
Trade accounts receivable, net of allowances (\$26 and \$41 at September 30, and March 31, 2008, respectively)	8,649	5,052
Unbilled revenue	5,899	8,763
Inventories	6,033	4,797
Income taxes receivable	2,779	1,502
Prepaid expenses and other current assets	581	463
Total current assets	66,796	57,370
Property, plant and equipment, net	9,458	9,060
Deferred income tax asset	86	70
Prepaid pension asset	6,959	4,186
Other assets	19	25
Total assets	\$ 83,318	\$ 70,711
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of capital lease obligations	\$ 27	\$ 20
Accounts payable	5,510	5,461
Accrued compensation	4,391	4,517
Accrued expenses and other liabilities	2,070	2,114
Customer deposits	5,617	5,985
Deferred income tax liability	2,275	2,275
Total current liabilities	19,890	20,372
Capital lease obligations	46	36
Accrued compensation	253	232
Deferred income tax liability	1,347	315
Accrued pension liability	282	271
Accrued postretirement benefits	932	949
Total liabilities	22,750	22,175
Stockholders' equity:		
Preferred stock, \$1 par value — Authorized, 500 shares Common stock, \$.10 par value — Authorized, 25,500 and 6,000 shares at September 30 and March 31, 2008, respectively Issued 10,127 and 9,982 shares at September 30 and March 31, 2008, respectively	1,013	499
Capital in excess of par value	14,808	12,674
Retained earnings	46,995	37,216
Accumulated other comprehensive loss	(2,203)	(1,820)
Other	(45)	(33)
Total stockholders' equity	60,568	48,536
Total liabilities and stockholders' equity	\$ 83,318	\$ 70,711

See Notes to Condensed Consolidated Financial Statements.

GRAHAM CORPORATION AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

(Unaudited)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
	(Amounts in thousands, except per share data)			
Net sales	\$ 23,915	\$ 23,060	\$ 51,562	\$ 43,047
Cost of products sold	13,416	13,163	28,845	26,471
Gross profit	<u>10,499</u>	<u>9,897</u>	<u>22,717</u>	<u>16,576</u>
Other expenses:				
Selling, general and administrative	3,931	3,438	7,753	6,516
Interest income	(172)	(264)	(303)	(494)
Interest expense	2	2	3	8
Total other expenses and income	<u>3,761</u>	<u>3,176</u>	<u>7,453</u>	<u>6,030</u>
Income before income taxes	6,738	6,721	15,264	10,546
Provision for income taxes	<u>2,326</u>	<u>2,299</u>	<u>5,168</u>	<u>3,466</u>
Net income	4,412	4,422	10,096	7,080
Retained earnings at beginning of period	42,786	25,236	37,216	22,675
Dividends	(203)	(99)	(354)	(196)
Effect of adoption of measurement date provisions of Statement of Financial Accounting Standards No. 158	—	—	37	—
Retained earnings at end of period	<u>\$ 46,995</u>	<u>\$ 29,559</u>	<u>\$ 46,995</u>	<u>\$ 29,559</u>
Per share data:				
Basic:				
Net income	<u>\$.43</u>	<u>\$.45</u>	<u>\$ 1.00</u>	<u>\$.72</u>
Diluted:				
Net income	<u>\$.43</u>	<u>\$.44</u>	<u>\$.99</u>	<u>\$.71</u>
Weighted average common shares outstanding:				
Basic:	10,169	9,859	10,127	9,835
Diluted:	10,249	10,029	10,227	10,030
Dividends declared per share	<u>\$.02</u>	<u>\$.01</u>	<u>\$.035</u>	<u>\$.02</u>

See Notes to Condensed Consolidated Financial Statements.

GRAHAM CORPORATION AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended September 30,	
	2008	2007
(Amounts in thousands)		
Operating activities:		
Net income	\$ 10,096	\$ 7,080
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	530	462
Discount accretion on investments	(293)	(421)
Stock-based compensation expense	257	78
Loss on disposal of property, plant and equipment	(1)	—
Deferred income taxes	1,267	3,014
(Increase) decrease in operating assets:		
Accounts receivable	(3,591)	487
Unbilled revenue	2,864	(475)
Inventories	(1,236)	1,231
Income taxes receivable/payable	(1,277)	(781)
Prepaid expenses and other current and non-current assets	(117)	(268)
Prepaid pension asset	(3,574)	(19)
Increase (decrease) in operating liabilities:		
Accounts payable	(18)	182
Accrued compensation, accrued expenses and other current and non-current liabilities	(176)	474
Customer deposits	(379)	(2,093)
Long-term portion of accrued compensation, accrued pension liability and accrued postretirement benefits	50	46
Total adjustments	(5,694)	1,917
Net cash provided by operating activities	<u>4,402</u>	<u>8,997</u>
Investing activities:		
Purchase of property, plant and equipment	(795)	(447)
Proceeds from sale of property, plant and equipment	1	25
Purchase of investments	(61,437)	(37,053)
Redemption of investments at maturity	58,600	27,750
Net cash used by investing activities	<u>(3,631)</u>	<u>(9,725)</u>
Financing activities:		
Proceeds from issuance of long-term debt	2,450	14
Principal repayments on long-term debt	(2,464)	(33)
Issuance of common stock	695	273
Dividends paid	(354)	(196)
Excess tax deduction on stock awards	1,696	—
Other	(12)	18
Net cash provided by financing activities	<u>2,011</u>	<u>76</u>
Effect of exchange rates on cash	<u>150</u>	<u>15</u>
Net increase (decrease) in cash and cash equivalents	2,932	(637)
Cash and cash equivalents at beginning of period	2,112	1,375
Cash and cash equivalents at end of period	<u>\$ 5,044</u>	<u>\$ 738</u>

See Notes to Condensed Consolidated Financial Statements.

GRAHAM CORPORATION AND SUBSIDIARY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2008 and 2007

(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 with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, 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 March 31, 2008 Condensed Consolidated Balance Sheet was derived from the Company's audited Consolidated Balance Sheet as of March 31, 2008. 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 year ended March 31, 2008, referred to as fiscal year 2008. 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, 2008 are not necessarily indicative of the results that may be expected for the year ending March 31, 2009, referred to as fiscal year 2009.

On October 26, 2007, the Company's Board of Directors declared a five-for-four stock split of the Company's common stock and increased the quarterly cash dividend to \$.03 per share, effective for the dividend paid on January 3, 2008 to stockholders of record on November 30, 2007. The five-for-four stock split was effected as a stock dividend, and stockholders received one additional share of common stock for every four shares of common stock held on the record date of November 30, 2007. The new common shares were distributed on January 3, 2008.

On July 31, 2008, the Company's stockholders approved a proposal to increase the number of authorized common shares from 6,000 to 25,500. Subsequently, the Company's Board of Directors declared a two-for-one stock split of the Company's common shares and increased the post-split quarterly cash dividend to \$.02 per share, effective for the dividend paid on October 6, 2008 to stockholders of record on September 5, 2008. The two-for-one stock split was effected as a stock dividend, and stockholders received one additional share of common stock for every share of common stock held on the record date of September 5, 2008. The new common shares were distributed on October 6, 2008. The par value of the Company's common stock, \$.10, remained unchanged as a result of the above-described stock dividends. All share and per share amounts disclosed for the three and six-month periods ended September 30, 2007 have been adjusted to reflect both the five-for-four and two-for-one stock splits.

Certain reclassifications have been made to prior year amounts to conform with the current year presentation. In the Condensed Consolidated Statements of Operations and Retained Earnings, interest income was reclassified from "Selling, general and administrative expense" to the separate line item "Interest income" for the three and six months ended September 30, 2007. In the March 31, 2008 Condensed Consolidated Balance Sheet, the line items "Treasury stock" and "Notes receivable from officers and directors" were combined and reported on the line item "Other."

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. During the three and six months ended September 30, 2008 and 2007, respectively, no loss provisions were recorded.

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 material obligations under its contracts after the revenue is recognized.

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 September 30, 2008 are scheduled to mature between October 2 and November 13, 2008.

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, 2008	March 31, 2008
Raw materials and supplies	\$ 1,796	\$ 2,047
Work in process	9,221	5,348
Finished products	<u>833</u>	<u>584</u>
	11,850	7,979
Less — progress payments	<u>5,817</u>	<u>3,182</u>
Total	<u>\$ 6,033</u>	<u>\$ 4,797</u>

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 in the three and six months ended September 30, 2008 were 2 and 18, respectively. Restricted stock awards in the three and six months ended September 30, 2008 were 0 and 4, respectively. Stock option awards vest 25% per year over a four year term. Restricted shares vest over a four year term as follows: (i) 10% on the first anniversary of the grant date; (ii) 20% on the second anniversary of the grant date; (iii) 30% on the third anniversary of the grant date; and (iv) 40% on the fourth anniversary of the grant date. All options have a term of ten years from their grant date.

During the three and six months ended September 30, 2008, the Company recognized stock-based compensation costs of \$166 and \$257, respectively. The income tax benefit recognized related to stock-based compensation was \$59 and \$91 for the three and six months ended September 30, 2008, respectively. During the three and six months ended September 30, 2007, the Company recognized stock-based compensation costs of \$45 and \$77, respectively. The income tax benefit recognized related to stock-based compensation was \$16 and \$27 for the three and six months ended September 30, 2007.

The weighted average fair value of stock options granted in the three and six months ended September 30, 2008 was \$23.47 and \$16.57, respectively. The weighted average fair value of

stock options granted in the three and six months ended September 30, 2007 was \$5.09 and \$3.00, respectively. The fair value of each stock option grant was estimated using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
Expected life	5 years	5 years	5 years	5 years
Expected volatility	64.17%	48.67%	61.80%	43.86%
Risk-free interest rate	3.25%	4.51%	3.22%	4.83%
Expected dividend yield	.23%	.55%	.28%	.63%

The expected life represents an estimate of the weighted average period of time that options are expected to remain outstanding given consideration to vesting schedules and the Company's historical exercise patterns. Expected volatility is estimated based on the historical closing prices of the Company's common stock over a period of five years. The risk free interest rate is estimated based on the United States Federal Reserve's historical data for the maturity of nominal treasury instruments that corresponds to the expected term of the option. Expected dividend yield is based on historical trends.

The fair value of a restricted share is equal to the market value of a share of the Company's stock on the date of grant. The weighted average fair value of the restricted shares granted in the six months ended September 30, 2008 and 2007 was \$30.88 and \$6.90, respectively.

The Graham Corporation Outside Directors' Long-Term Incentive Plan (the "Plan") provides for awards of share equivalent units for outside directors based upon the Company's performance. Each unit is equivalent to one share of the Company's common stock. Share equivalent units are credited to each outside director's account for each of the first five full fiscal years of the director's service when the Company's consolidated net income is at least 100% of the approved budgeted net income for the year. Share equivalent units are payable in cash or stock upon retirement.

Compensation cost for share equivalent units is recorded based on the higher of the quoted market price of the Company's stock at the end of the period up to \$3.20 per unit or the stock price at the date of grant. The cost of share equivalent units earned and charged to pre-tax income under the Plan was \$10 and \$7 in the three-month periods ended September 30, 2008 and 2007, respectively, and \$20 and \$15 in the six-month periods ended September 30, 2008 and 2007, respectively. There were 54 and 75 share equivalent units in the Plan at September 30, 2008 and 2007, respectively, and the related liability recorded was \$253 and \$296 at September 30, 2008 and 2007, respectively. The expense to mark to market the share equivalent units was \$0 in both the three month periods ended September 30, 2008 and 2007. The expense to mark to market the share equivalent units was \$0 and \$8 in the six months ended September 30, 2008 and 2007, respectively.

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 September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
Basic income per share				
Numerator:				
Net income	\$ 4,412	\$ 4,422	\$ 10,096	\$ 7,080
Denominator:				
Weighted common shares outstanding	10,108	9,785	10,060	9,760
Share equivalent units ("SEUs")	61	74	67	75
Weighted average common shares and SEUs	10,169	9,859	10,127	9,835
Basic income per share	\$.43	\$.45	\$ 1.00	\$.72
Diluted income per share				
Numerator:				
Net income	\$ 4,412	\$ 4,422	\$ 10,096	\$ 7,080
Denominator:				
Weighted average shares and SEUs outstanding	10,169	9,859	10,127	9,835
Stock options outstanding	80	170	100	195
Weighted average common and potential common shares outstanding	10,249	10,029	10,227	10,030
Diluted income per share	\$.43	\$.44	\$.99	\$.71

Options to purchase a total of 2 shares of common stock were outstanding at September 30, 2008, but were not included in the above computation of diluted income per share as their effect would be anti-dilutive.

NOTE 7 – PRODUCT WARRANTY LIABILITY:

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
Balance at beginning of period	\$ 367	\$ 405	\$ 441	\$ 357
Expense for product warranties	96	91	64	230
Product warranty claims paid	(106)	(45)	(148)	(136)
Balance at end of period	<u>\$ 357</u>	<u>\$ 451</u>	<u>\$ 357</u>	<u>\$ 451</u>

NOTE 8 – CASH FLOW STATEMENT:

Interest paid was \$3 and \$8 for the six months ended September 30, 2008 and 2007, respectively. In addition, income taxes paid were \$3,483 and \$1,253 for the six months ended September 30, 2008 and 2007, respectively.

During the six months ended September 30, 2008, 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.

Non-cash activities during the six months ended September 30, 2008 included a reclassification from “Capital in excess of par value” to “Common stock” for \$506, which represents the par value of the additional shares issued to effect the two-for-one stock split effected in the form of a stock dividend. See Note 1. Non-cash activities during the six months ended September 30, 2008 also included \$543, net of income tax, in pension and other postretirement benefit adjustments required by the adoption of the measurement date provisions of Statement of Financial Accounting Standards (“SFAS”) No. 158, *Employer’s Accounting for Defined Benefit Pension and Other Postretirement Plans*. See Note 13. In addition, capital expenditures totaling \$31 were financed through the issuance of capital leases.

NOTE 9 – COMPREHENSIVE INCOME:

Total comprehensive income was as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
Net income	\$ 4,412	\$ 4,422	\$ 10,096	\$ 7,080
Other comprehensive income:				
Foreign currency translation adjustment	2	7	141	15
Defined benefit pension and other postretirement plans	9	13	(524)	27
Total comprehensive income	<u>\$ 4,423</u>	<u>\$ 4,442</u>	<u>\$ 9,713</u>	<u>\$ 7,122</u>

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 and the effect of the Company’s adoption of the measurement date provisions of SFAS No. 158 on April 1, 2008. See Note 13.

NOTE 10 – EMPLOYEE BENEFIT PLANS:

The components of pension cost are as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
Service cost	\$ 112	\$ 122	\$ 225	\$ 243
Interest cost	309	277	618	554
Expected return on assets	(459)	(408)	(918)	(816)
Amortization of:				
Unrecognized prior service cost	1	1	2	2
Actuarial loss	50	55	100	111
Net pension cost	<u>\$ 13</u>	<u>\$ 47</u>	<u>\$ 27</u>	<u>\$ 94</u>

The Company contributed \$3,500 to its defined benefit pension plan during the six months ended September 30, 2008. The Company does not expect to make any contributions to the plan for the balance of fiscal year 2009.

Subsequent to March 31, 2008, conditions in the worldwide debt and equity markets have deteriorated significantly. These conditions have had a negative effect on the fair value of the plan's investments since March 31, 2008. However, we are unable to quantify the exact effect on the plan.

The components of the postretirement benefit income are as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
Service cost	\$ —	\$ —	\$ —	\$ —
Interest cost	15	15	30	30
Amortization of prior service cost	(42)	(41)	(83)	(83)
Amortization of actuarial loss	6	6	12	12
Net postretirement benefit income	<u>\$ (21)</u>	<u>\$ (20)</u>	<u>\$ (41)</u>	<u>\$ (41)</u>

The Company paid benefits of \$12 related to its postretirement benefit plan during the six months ended September 30, 2008. The Company expects to pay benefits of approximately \$117 for the balance of fiscal year 2009.

NOTE 11 – CONTINGENCIES AND COMMITMENTS:

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 minimal amounts below the expected defense costs. Neither the outcome of these lawsuits nor the potential for liability can be determined at this time.

From time to time in the ordinary course of its business, the Company is subject to legal proceedings and potential claims. At September 30, 2008, other than noted above, management was unaware of any additional 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 subject to examination by the United States Internal Revenue Service for tax years 2005 through 2008 and tax years 2006 and 2007 are currently under examination. The Company is subject to examination in state and international tax jurisdictions for tax years 2004 through 2008 and tax years 2006 through 2008, 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 unrecognized tax benefits as of September 30, 2008 and has not recorded any interest or penalties related to uncertain tax positions for the six-month period ended September 30, 2008.

NOTE 13 – ACCOUNTING AND REPORTING CHANGES:

In September 2006, the Financial Accounting Standard Board ("FASB") issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS No. 157 was effective as of the beginning of fiscal year 2009, except as it relates to nonrecurring fair value measurements of nonfinancial assets and liabilities for which SFAS No. 157 is effective for fiscal years beginning after November 15, 2008. The adoption of all provisions of SFAS No. 157 had no effect on the Company's financial position, results of operations and cash flows.

On April 1, 2008, the Company adopted the measurement date provisions of SFAS No. 158, *Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans*, utilizing the remeasurement approach which required plan assets and benefit obligations to be remeasured as of the beginning of fiscal year 2009. The following table presents the impact of initially applying the measurement date provisions of SFAS No. 158 on individual line items in the Company's Consolidated Balance Sheet as of April 1, 2008:

Balance Sheet Caption	Before Application of SFAS No. 158	Adjustments	After Application of SFAS No. 158
Prepaid pension asset	\$ 4,186	\$ (801)	\$ 3,385
Long-term deferred income tax liability	\$ (315)	\$ 260	\$ (55)
Accrued postretirement benefits	\$ (949)	\$ 35	\$ (914)
Accumulated other comprehensive loss	\$ 1,820	\$ 543	\$ 2,363
Retained earnings	\$ (37,216)	\$ (37)	\$ (37,253)

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to choose to measure various financial instruments and certain other items at fair value in order to mitigate volatility in reporting earnings caused by measuring related assets and liabilities differently. SFAS No. 159 was effective as of April 1, 2008. The Company has decided not to change how it measures financial instruments and certain other items covered under SFAS No. 159.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, to enhance disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company does not believe the adoption of SFAS No. 161 will have a material effect on its consolidated financial statement disclosures.

Item 1A. Risk Factors

Our business and operations are subject to numerous risks, many of which are discussed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended March 31, 2008. If any of the events that are described in the Item 1A of such Form 10-K or which are described below should occur, our business and results of operations could be harmed.

The following new risk factors should be considered in addition to those contained in our Annual Report on Form 10-K for the year ended December 31, 2007.

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 will likely 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 few years remain essentially unchanged and that our long-term growth prospects remain strong, we also expect that the current economic crisis in the capital and credit markets will cause 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 also 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 current crises in 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 desirable to expand our business.

One of the larger markets we serve is 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 several years and that there is a shortage of 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 large 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.

The following risk factor is intended to supplement and replace the risk factor with the same heading which is contained in Item 1A of our Annual Report on Form 10-K for the year ended March 31, 2008.

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 we are in a long-term expansion of demand for our products in the petrochemical, petroleum refining and power generating industries, a downturn in one or more of these industries could occur at any time. We have no way to predict or control the length or severity of any such downturn. 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.

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, liquid ring pump packages, condensers and heat exchangers. Our equipment is for critical applications in the petrochemical, oil refinery and electric power generation industries, including cogeneration and geothermal plants. Our equipment can also be found in diverse applications such as metal refining, pulp and paper processing, shipbuilding, water heating, refrigeration, desalination, food processing, pharmaceuticals, heating, ventilating and air conditioning.

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

Highlights for the three and six months ended September 30, 2008 are set forth below. Our current fiscal year, which we refer to as "fiscal 2009," ends March 31, 2009.

- Net income and income per diluted share for the current quarter were \$4,412 and \$0.43, compared with net income of \$4,422 and income per diluted share of \$0.44 for the quarter ended September 30, 2007. Net income and income per diluted share for the six months ended September 30, 2008 were \$10,096 and \$0.99, compared with net income and income per diluted share for the six-month period ended September 30, 2007 of \$7,080 and \$0.71.
- Net sales for the second quarter of \$23,915 were up 4% compared with the second quarter of the fiscal year ended March 31, 2008, referred to as "fiscal 2008," when sales were \$23,060. Net sales for the first six months of fiscal 2009 were \$51,562, an increase of 20%, compared with \$43,047 for the six months ended September 30, 2007.
- Orders placed with us in the three and six-month periods of fiscal 2009 were \$17,451 and \$45,251, respectively, compared with the three and six-month periods of fiscal 2008 of \$20,528 and \$45,371, respectively. We believe orders for the current quarter were down 15% compared with the same period of the prior fiscal year as a result of a hesitation in the capital construction markets caused by the current global economic crises. For the comparative six month-periods, orders were level.
- Backlog grew to \$69,673 at September 30, 2008, representing a 23% increase compared with September 30, 2007, when backlog was \$56,839. However, as a result of the second quarter decline in new orders, backlog was down from \$75,971 at the end of the first quarter of fiscal 2009.
- Gross profit margin was 44% for both the three and six-month periods ended September 30, 2008 compared with 43% and 39% for the three and six-month periods ended September 30, 2007, respectively.
- Operating margins for the quarter and six-month periods ended September 30, 2008 were 27% and 29%, respectively, compared with 28% and 23%, respectively, for the quarter and six-month periods ended September 30, 2007.

- Cash and short-term investments at September 30, 2008 were \$42,855, up 16% as compared with \$36,793 at March 31, 2008.

We expect that the current global economic crisis has caused a slow-down in spending by our customers as they evaluate the current and future economic impact to their project plans. However, we believe the principal market drivers that have driven our growth over the last two years are unchanged and that ultimately they will continue to drive long-term growth.

We believe the principal market drivers that have led to increased capital spending by our customers and that are contributing to our sales growth include:

- Global consumption of crude oil is estimated to expand over the next decade.
- There is a shortage of global oil refining capacity, which is being addressed through refinery upgrades, revamps, new builds and expansions.
- There is a differential in raw material prices for higher quality sweet and lower quality sour crude oil. To lower production costs, many refineries are upgrading facilities in order to be able to process sour crude oil, which requires an upgrade of vacuum and heat transfer equipment of the types we design and manufacture.
- The expansion of the middle class in Asia is driving increasing demand for power, refinery and petrochemical products.
- The high cost of natural gas in North America and Europe is leading to the construction of new petrochemical plants in the Middle East, where natural gas is plentiful and less expensive.
- There is an increased demand for geothermal electrical power plants to meet increased electricity demand.
- Refineries in the United States are being upgraded to process synthetic crude oil from oil sands located in Alberta, Canada.

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 2008 and in Item 1A of this Report. 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;

- plans for future products and services and for enhancements to existing products and services;
- estimates regarding our liquidity and capital requirements;
- 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,” “intend,” “project,” “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 these 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.

Results of Operations

For an understanding of the significant factors that influenced our performance, the following discussion should be read in conjunction with our Condensed Consolidated Financial Statements and the notes to our condensed consolidated financial statements included in Item 1 of this Quarterly Report on Form 10-Q.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2008	2007	2008	2007
Net sales	\$23,915	\$23,060	\$51,562	\$43,047
Net income	4,412	4,422	10,096	7,080
Diluted income per share	0.43	0.44	0.99	0.71
Identifiable assets	83,318	54,878	83,318	54,878

The Second Quarter of Fiscal 2009 Compared With the Second Quarter of Fiscal 2008

Sales for the second quarter of fiscal 2009 were \$23,915, a 4% increase as compared with sales of \$23,060 for the second quarter of fiscal 2008. A \$2,058 increase in sales of pumps combined with a \$996 and \$806 increase in sales of condensers and heat exchangers, respectively, more than offset the \$3,314 decline in sales of ejectors. The second quarter of fiscal 2008 included two large ejector orders for the refinery market. Aftermarket sales were up \$309 in the current quarter compared with the same period last year.

Sales for the six-month period ended September 30, 2008 were \$51,562, up 20%, compared with \$43,047 for the first six months of fiscal 2008. Heat exchanger sales increased \$1,484, condenser sales increased \$2,957, pump package sales increased \$3,410 and aftermarket sales increased \$6,335 for the first half of fiscal 2009. The increases in pump package and aftermarket sales were due to three large refinery projects. These increases more than offset the \$5,671 decrease in ejector sales in the six month-period ended September 30, 2008 compared with the first half of our prior fiscal year.

International sales accounted for 37% and 33% of total sales for the second quarters of fiscal 2009 and fiscal 2008, respectively. International sales increased \$1,450 in the current quarter compared with the three-month period ended September 30, 2007 with increases of \$2,498 and \$1,242 from the Middle East and Western Europe, respectively, more than offsetting declines in Asia, South America and other areas. We believe this trend of international sales comprising a larger percentage of our total sales will continue into fiscal 2010. For the six months ended September 30, 2008, international orders were 35% of total sales compared with 43% for the six-month period ended September 30, 2007. International sales dollars of \$18,026 for the current six-month period compared with the six months ended September 30, 2007 were relatively unchanged.

Fluctuations in sales among products and geographic locations can vary measurably from period to period based on timing and magnitude of projects. Sales in the three months ended September 30, 2008 were 47% to the refining industry, 27% to the chemical and petrochemical industries, 8% to the power industry and 18% to other industrial applications. Sales in the three months ended September 30, 2007 were 52% to the refining industry, 28% to the chemical and petrochemical industries, 2% to the power industry and 18% to other industrial applications. Increased sales to the power industry included applications for fossil fuels while other industrial applications included heating, ventilation and air conditioning requirements and sales to the pulp and paper industry. For the six-month periods ended September 30, 2008 and 2007, sales were, respectively, 50% and 50% to the refinery industry, 23% and 26% to the chemical and petrochemical industries, 6% and 3% to the power industry and 21% and 21% to other industrial applications. For additional information on future sales and our markets, see "Orders and Backlog" below.

Our gross profit percentage for the second quarter of fiscal 2009 was 44% compared with 43% for the second quarter of fiscal 2008. Gross profit percentage for the six-month periods ended September 30, 2008 and 2007 was 44% and 39%, respectively. Gross profit dollars for the first half of fiscal 2009 increased 37% compared with fiscal 2008, primarily as a result of a 20% increase in sales. The higher gross profit percentage and dollars were due mostly to improved product mix achieved by increased selectivity on orders accepted and higher volume. We were able to increase our sales volume through productivity improvements made in engineering and manufacturing by process improvements, technology and new equipment. The efficiencies we have gained have enabled us to control our fixed cost structure on higher sales volumes.

Selling, general and administrative ("SG&A") expenses, expressed as a percent of sales, for the three-month periods ended September 30, 2008 and 2007 were 16% and 15%, respectively. SG&A expense, expressed as a percent of sales, was 15% for both the six-month periods ended September 30, 2008 and 2007. Actual costs for fiscal 2009 for the three and six-month periods ended September 30, 2008, compared with the same respective periods in fiscal 2008, increased \$493, or 14%, and \$1,237, or 19%, respectively. Higher SG&A expenses were due to increased sales commissions related to higher sales and to increased variable compensation as a result of a 43% increase in net income for the six-month period. In addition, we incurred consulting costs for information technology, engineering and manufacturing projects which we believe will lead to reduced cycle time, greater efficiencies and capacity expansion.

Interest income for the three month-periods ended September 30, 2008 and 2007 was \$172 and \$264, respectively. For the six-month periods ended September 30, 2008 and 2007, interest income was \$303 and \$494, respectively. Decreased interest income was due to lower interest rates and investing in lower risk and yield instruments. Our investments at September 30, 2008 consisted solely of fixed income debt securities issued by the United States Treasury.

Interest expense was \$2 for each of the quarters ended September 30, 2008 and 2007. For the six-month periods ended September 30, 2008 and 2007, respectively, interest expense was \$3 and \$8. The decrease was due to lower interest rates and a decline in capital lease obligations outstanding.

Our effective income tax rate in fiscal 2009 is projected to be 33%. However, for the six months ended September 30, 2008, our actual effective income tax rate was 34% due to our Chinese subsidiary's taxable loss at September 30, 2008 for which the related tax benefit was recognized at the lower foreign statutory rate. Our effective tax rate for fiscal 2008 was 33%.

Net income for the fiscal 2009 second quarter was \$4,412, relatively unchanged from \$4,422 for the fiscal 2008 second quarter as increased expenses offset the effect of higher sales. For the six-month period of fiscal 2009, net income was up 43% to \$10,096 compared with \$7,080 for the six month-period of fiscal 2008. Income per diluted share was \$0.43 and \$0.99 for the three and six month-periods ended September 30, 2008, respectively, compared with \$0.44 and \$0.71 for the three and six-month periods ended September 30, 2007, respectively. The increase in the weighted average shares outstanding in the fiscal 2009 second quarter resulted in slightly lower diluted earnings per share.

Liquidity and Capital Resources

The following discussion should be read in conjunction with our Condensed Consolidated Statements of Cash Flows:

	September 30,	
	2008	2007
Cash and investments	\$42,855	\$24,137
Working capital	\$46,906	\$30,425
Working capital ratio ⁽¹⁾	3.4	3.0
Long-term debt (capital leases)	\$ 46	\$ 45
Long-term debt/capitalization ⁽²⁾	0%	0.1%
Long-term liabilities/capitalization ⁽³⁾	4.7%	4.5%

1) 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.

Net cash provided by operating activities for the first six months of fiscal 2009 was \$4,402, compared with \$8,997 for the six months ended September 30, 2007. The decrease was due to an increase in working capital, decreases in net operating losses and research and development credits available to reduce current taxes payable, and a contribution we made to our pension plan. The contribution to the pension plan in the current six-month period was \$3,500 compared with \$0 for the six months ended September 30, 2007. Expressed as a percent of income before taxes, the current income tax provision for the first half of fiscal 2009 was 26% compared with 4% for the first half of fiscal 2008. Our working capital rose due to an increase in our accounts receivable balance. The higher accounts receivable balance at September 30, 2008 does not represent a change in collection terms, but was due to the timing of billings to customers.

We invest net cash generated from operations in excess of cash held for near-term needs in marketable securities. Investments are United States government instruments, generally with maturity periods of 91 to 120 days. Investments at September 30, 2008 and March 31, 2008 were

\$37,811 and \$34,681, respectively. Other investing activities in the first six months of fiscal 2009 included capital expenditures of \$795.

Sources of cash from financing activities for the six months ended September 30, 2008 included the issuance of common stock for stock options exercised, which raised \$695, compared with \$273 in the first six months of fiscal 2008. In the six-month period ended September 30, 2008, we also recognized a \$1,696 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.

Uses of cash for financing activities for the six months ended September 30, 2008 included dividend payments of \$354 compared with \$196 for the six-month period ended September 30, 2007. In the first half of fiscal 2009, we borrowed and repaid \$14 to finance working capital needs compared with \$19 for the first half of fiscal 2008.

We have a credit facility with Bank of America, N.A. that provides a line of credit up to \$30,000, including letters of credit and bank guarantees. Borrowings under our credit facility are secured by all of our assets. Borrowings and standby letters of credit outstanding under our credit facility on September 30, 2008 were \$0 and \$8,796, respectively. Our borrowing rate as of September 30, 2008 was the bank's prime rate minus 125 basis points, or 3.75%. We believe that cash generated from operations, combined with our investment and available financing capacity under our credit facility will be adequate to meet our cash needs in the foreseeable future.

Capital expenditures for fiscal 2009 are projected to be approximately \$1,800 to \$2,200. Planned investment is expected to be about 33% in machinery and equipment, 53% for information technology and 14% for all other capital expenditures. We estimate 68% of our capital expenditure budget for fiscal 2009 will support productivity improvements, while the balance will be primarily used for capitalized maintenance projects. Capital expenditures in fiscal 2008 were 60% for plant machinery and equipment and 40% for all other capital expenditures. Fifty-six percent of our capital spending was for productivity improvements, while the balance was primarily for capitalized maintenance.

Orders and Backlog

Orders for the three and six-month periods ended September 30, 2008 were \$17,451 and \$45,251, respectively. Orders for the three and six-month periods ended September 30, 2007 were \$20,528 and \$45,371, respectively. Orders represent communications received from customers requesting us to supply products and services and can fluctuate significantly quarter to quarter by industry and product lines and, therefore, we do not believe quarter to quarter comparisons reflect business trends. Orders in the second quarter of fiscal 2009 were down \$3,077 from the prior year's second quarter. A \$2,076 increase in ejector orders in the fiscal 2009 second quarter did not offset a \$3,013 decline in pump package orders and a \$1,618 decline in condenser orders compared with the fiscal 2008 second quarter.

We experienced a significant increase in orders for surface condensers in the first half of fiscal 2009 of \$3,488, or 33%, compared with the first half of fiscal 2008. Surface condenser orders represented 31% of our orders in the six-month period ended September 30, 2008 compared with 24% in the six-month period ended September 30, 2007. Condenser orders were for refinery, petrochemical and electric power applications. Offsetting the increase in condenser orders for the first half of fiscal 2009 was a decrease in pump package orders for the six-month period ended September 30, 2008 compared with the six months ended September 30, 2007 of \$4,843. The large pump package orders received last fiscal year were for refinery projects and approximately half of the total order value was converted to sales in the first six months of fiscal 2009. We

believe any of our product categories in any given period could constitute a significant percentage of the orders for that period and do not necessarily represent business trends.

Domestic orders for the fiscal 2009 second quarter were 52% of total orders, or \$9,104. They were down \$2,732, or 23%, compared with domestic orders of \$11,836, or 58% of total orders, in the second quarter of fiscal 2008. International orders were 48% of total orders, or \$8,347, in the second quarter of fiscal 2009 compared with the second quarter of fiscal 2008, when international orders were 42%, or \$8,692. Declines by industry were in the refining and power markets.

For the six month-period ended September 30, 2008, international orders were 59% of total orders, or \$26,491, compared with 29% of total orders, or \$13,221, in the first six months of 2008. The increase in international orders for the first six months of fiscal 2009 came primarily from Asia, up \$16,174, which represented 36% of our total orders for fiscal 2009 through the second quarter. Our domestic orders in both periods were comprised mostly of refinery projects. International orders were for refinery, petrochemical and power generation applications. We believe, subject to order selection, that in the future, some periods can be heavily weighted toward international orders and other periods to domestic orders, but that the emerging trend in the foreseeable future will result in a greater weighting toward international orders. By industry, the \$5,170 increase in orders from the chemical and petrochemical industry and the \$3,999 increase in orders from other industrial and commercial applications were not enough to offset the decline in orders from the refining industry and the power industry of \$6,478 and \$2,814, respectively, in the first half of fiscal 2009 when compared with the same period in fiscal 2008. We believe that the rapid decline in oil prices in the quarter ended September 30, 2008 and the current global economic crisis caused our customers to hold orders until markets become more stable.

Backlog was \$69,673 at September 30, 2008, compared with \$56,839 at September 30, 2007, a 23% increase. Backlog is defined as the total dollar value of orders received for which revenue has not yet been recognized. All orders in backlog represent orders from our traditional markets in established product lines. Substantially all of our current backlog is expected to be converted to sales within the next twelve months, and represents orders from traditional markets in our established product lines. At September 30, 2008, approximately 51% of our backlog was attributable to equipment for refinery project work, 30% to chemical and petrochemical projects, and 19% to other industrial or commercial applications. At September 30, 2007, approximately 50% of our backlog was attributable to equipment for refinery project work, 26% to chemical and petrochemical projects, and 24% to other industrial or commercial applications, including electrical power.

Contingencies and Commitments

We have been named as a defendant in certain lawsuits alleging personal injury from exposure to asbestos contained in our products. We are a co-defendant with numerous other defendants in these lawsuits and intend to vigorously defend against these claims. The claims are similar to previous asbestos lawsuits that named us as a defendant. Such previous lawsuits either were dismissed when it was shown that we had not supplied products to the plaintiffs' places of work or were settled by us for amounts below expected defense costs. Neither the outcome of these lawsuits nor the potential for liability can be determined at this time.

From time to time in the ordinary course of business, we are subject to legal proceedings and potential claims. As of September 30, 2008, other than noted above, we were unaware of any pending material litigation.

Critical Accounting Policies, Estimates and Judgments

Our unaudited condensed consolidated financial statements are based on the selection of accounting policies and the application of significant account estimates, some of which require management to make significant assumptions. We believe that the most critical accounting estimates used in the preparation of our condensed consolidated financial statements relate to labor hour estimates used to recognize revenue under the percentage-of-completion method, accounting for contingencies, under which we accrue a loss when it is probable that a liability has been incurred and the amount can be reasonably estimated, and accounting for pensions and other postretirement benefits. For further information, refer to Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Item 8 “Financial Statements and Supplementary Data” in our Annual Report on Form 10-K for our fiscal year ended March 31, 2008.

New Accounting Pronouncements

In September 2006, the Financial Accounting Standard Board (“FASB”) issued Statement of Financial Accounting Standard (“SFAS”) No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 was effective as of the beginning of fiscal 2009, which commenced April 1, 2008. The impact of adopting all provisions of SFAS No. 157 had no effect on our financial position, results of operations and cash flows when adopted.

In September 2006, the FASB issued SFAS No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans*. In our fiscal year ended March 31, 2007, we adopted the provisions of SFAS No. 158 which were effective for that year. Effective April 1, 2008 we recognized the effects of changing our measurement dates for our defined benefit plans from a December 31 to a March 31 date. Under the approach we selected, we remeasured our plan assets and benefit obligations as of the beginning of fiscal 2009. Our adoption of SFAS No. 158 had the effect of reducing our prepaid pension asset by \$801, reducing our deferred income tax liability by \$260, reducing stockholders’ equity by \$506 and decreasing accrued postretirement benefits by \$35.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits entities to choose to measure certain financial instruments and certain other items at fair value in order to mitigate volatility in reported earnings. SFAS No. 159 was effective as of April 1, 2008. We have determined not to change how we measure financial instruments and certain other items covered under SFAS No. 159.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* to enhance disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations and how derivative instruments and related hedged items affect an entity’s financial position, financial performance and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We do not believe the adoption of SFAS No. 161 will have a material effect on our consolidated financial statement disclosures.

Off Balance Sheet Arrangements

We did not have any off balance sheet arrangements as of September 30, 2008 or 2007, other than operating leases.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The principal market risks (i.e., the risk of loss arising from changes in market rates and prices) to which we are exposed is foreign currency exchange rates and price risk.

The assumptions applied in preparing the following qualitative and quantitative disclosures regarding foreign currency exchange rate risk are based upon volatility ranges experienced by us in relevant historical periods, our current knowledge of the marketplace, and our judgment of the probability of future volatility based upon the historical trends and economic conditions of the markets in which we operate.

Foreign Currency

International consolidated sales for the first six months of fiscal 2009 were 35% of total sales compared with 43% for the first six months of fiscal 2008. Operating in markets throughout the world exposes us to movements in currency exchange rates. Currency movements can affect sales in several ways, the foremost being our ability to compete for orders against foreign competitors that base their prices on relatively weaker currencies. Business lost due to competition for orders against competitors using a relatively weaker currency cannot be quantified. In addition, cash can be adversely impacted by the conversion of sales made by us in a foreign currency to United States dollars. In the six-month periods ended September 30, 2008 and 2007, we had no sales for which we were paid in foreign currencies.

We have limited exposure to foreign currency purchases. In the three and six-month periods ended September 30, 2008 and 2007, our purchases in foreign currencies represented 2% and 3%, and 2% and 4%, respectively, of the cost of products sold.

At certain times, we may utilize forward foreign currency exchange contracts to limit currency exposure. Forward foreign currency exchange contracts were not used in the periods being reported on and, as of September 30, 2008 and September 30, 2007, we held no forward currency contracts.

Price Risk

Operating in a global marketplace requires us to compete with other global manufacturers which, in some instances, benefit from lower production costs and more favorable economic conditions. Although we believe that our customers differentiate our products on the basis of our manufacturing quality and engineering experience and excellence, among other things, such lower production costs and more favorable economic conditions mean that certain of our competitors are able to offer products similar to ours at lower prices. Moreover, the cost of metals and other materials used in our products have experienced significant volatility. Currently, we are experiencing a decline in the cost of metals and other materials. Such factors, in addition to the global effects of the recent volatility and disruption of the capital and credit markets, make it likely that we will encounter downward pricing pressure for our products in the near term.

Item 4. Controls and Procedures

Conclusion regarding the effectiveness of disclosure controls and procedures

Our president and chief executive officer (principal executive officer) and controller and chief accounting officer (principal accounting officer) each have evaluated the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, and as of such date, our president and chief executive officer and controller and chief accounting officer concluded that our disclosure controls and procedures were effective in all material respects.

Changes in internal control over financial reporting

There has been no change to our internal control over financial reporting during the quarter covered by this Quarterly Report on Form 10-Q that has materially affected, or that is reasonably likely to materially affect, our internal control over financial reporting.

GRAHAM CORPORATION AND SUBSIDIARY

FORM 10-Q

September 30, 2008

PART II — OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

On July 31, 2008, the Company's stockholders voted on the following proposals at the Company's 2008 Annual Meeting of Stockholders:

Proposal 1:

To elect each of Gerard T. Mazurkiewicz and Cornelius S. Van Rees as a director of the Company, each to serve for a three-year term expiring in 2011 or until his respective successor is elected and qualified:

Nominees	Votes For	Votes Withheld
Gerard T. Mazurkiewicz	4,356,845	93,397
Cornelius S. Van Rees	4,332,969	117,273

The other directors, whose terms of office continued after the annual meeting, were Helen H. Berkeley, Jerald D. Bidlack, James R. Lines and James J. Malvaso. Subsequent to the annual meeting, Alan Fortier was appointed as a director.

Proposal 2:

To approve the amendment to the Company's Amended Certificate of Incorporation to increase the number of authorized shares of common stock from 6,000,000 to 25,500,000 and to increase the number of total authorized shares from 6,500,000 to 26,000,000.

Votes for:	2,845,517
Votes against:	1,570,992
Votes abstained:	33,733

Proposal 3:

To ratify the selection of Deloitte & Touche LLP as the Company's independent registered public accounting firm for the fiscal year ending March 31, 2009

Votes for:	4,337,895
Votes against:	92,277
Votes abstained:	20,070

Item 5. Other Information

On July 31, the Company's stockholders approved an amendment to the Company's Amended Certificate of Incorporation to increase the number of authorized shares of common stock, having a par value of \$0.10 per share, from 6,000,000 to 25,500,000 and to increase the number of total authorized shares from 6,500,000 to 26,000,000. Such amendment became effective with the State of Delaware Secretary of State as of July 31, 2008.

Item 6. Exhibits

See index to exhibits on page 31 of this report.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GRAHAM CORPORATION

By: /s/ Jennifer R. Condame
Jennifer R. Condame
Controller and Chief Accounting Officer

Date: November 5, 2008

INDEX OF EXHIBITS

- (3) Articles of Incorporation and By-Laws
 - 3.1 Certificate of Incorporation, as amended, of Graham Corporation
- (10) Material Contracts
 - # 10.1 Form of Director Non-Qualified Stock Option Agreement
 - # 10.2 Form of Employee Non-Qualified Stock Option Agreement
 - # 10.3 Form of Employee Restricted Stock Agreement
- (31) Rule 13a-14(a)/15d-14(a) Certifications
 - 31.1 Certification of Principal Executive Officer
 - 31.2 Certification of Principal Financial Officer
- (32) Section 1350 Certifications
 - 32.1 Section 1350 Certifications

Management contract or compensatory plan.

**CERTIFICATE OF INCORPORATION
OF
GRAHAM CORPORATION**

* * * * *

FIRST: The name of the Corporation is GRAHAM CORPORATION.

SECOND: The address of its registered office in the State of Delaware is No. 100 West Tenth Street, in the City of Wilmington, County of New Castle. The name of its registered agent at such address is The Corporation Trust Company.

THIRD: The nature of the business or purposes to be conducted or promoted is:

To engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware.

FOURTH: The total number of shares of all classes of stock which the Corporation shall have authority to issue is 2,500,000 shares, of which 500,000 shares shall be shares of Preferred Stock having a par value of \$1.00 each (hereinafter called Preferred stock) and 2,000,000 shares shall be shares of Common Stock having a par value of \$0.10 each (hereinafter called Common Stock).

Authority is hereby expressly granted to the Board of Directors from time to time to issue the Preferred Stock as Preferred Stock of one or more series and in connection with the creation of any such series to fix by the resolution or resolutions providing for the issue of shares thereof the designation, powers, preferences, and relative, participating, optional, or other special rights of such series, and the qualifications, limitations, or restrictions thereof. Such authority of the Board of Directors with respect to each such series shall include, but not be limited to, the determination of the following:

- (a) the distinctive designation of, and the number of shares comprising, such series, which number may be increased (except
-

where otherwise provided by the Board of Directors in creating such series) or deceased (but not below the number of shares thereof then outstanding) from time to time by like action of the Board of Directors;

(b) the dividend rate or amount of such series, the conditions and dates upon which such dividends shall be payable, the relation which such dividends shall bear to the dividends payable on any other class or classes or any other series of any class or classes of stock, and whether such dividends shall be cumulative, and if so, from which date or dates for such series;

(c) whether or not the shares of such series shall be subject to redemption by the Corporation and the times, prices, and other terms and conditions of such redemption;

(d) whether or not the shares of such series shall be subject to the operation of a sinking fund or purchase fund to be applied to the purchase or redemption of such shares and if such a fund be established, the amount thereof and the terms and provisions relative to the application thereof;

(e) whether or not the shares of such series shall be convertible into or exchangeable for shares of any other class or classes, or of any other series of any class or classes of stock of the Corporation and if provision be made for conversion or exchange, the times, prices, rates, adjustments, and other terms and conditions of such conversion or exchange;

(f) whether or not the shares of such series shall have voting rights, in addition to the voting rights provided by law, and if they are to have such additional voting rights, the extent thereof;

(g) the rights of the shares of such series in the event of any liquidation, dissolution, or winding up of the Corporation or upon any distributions of its assets; and

(h) any other powers, preferences, and relative, participating, optional, or other special rights of the shares of such series, and qualifications, limitations, or restrictions thereof, to the full extent now or hereafter permitted by law and not inconsistent with the provisions hereof.

All shares of any one series of preferred Stock shall be identical in all respects except as to the dates from which dividends thereon shall be cumulative. All series of the Preferred Stock shall rank equally and be identical in all respects except as otherwise provided in the resolution or resolutions providing for the issue of any series of Preferred Stock.

Whenever dividends upon the Preferred Stock at the time outstanding, to the extent of the preference to which such stock is entitled, shall have been paid in full or declared and set apart for payment for all past dividend periods, and after the provisions for any sinking or purchase fund or funds for any series of Preferred Stock shall have been complied with, the Board of Directors may declare and pay dividends on the Common Stock, payable in cash, stock, or otherwise, and the holders of shares of Preferred Stock shall not be entitled to share therein, subject to the provisions of the resolution or resolutions creating any series of Preferred stock.

In the event of any liquidation, dissolution, or winding up of the Corporation or upon the distribution of the assets of the Corporation, all assets and funds of the Corporation remaining, after the payment to the holders of the Preferred Stock of the full preferential amounts to which they shall be entitled as provided in the resolution or resolutions creating any series thereof, shall

be divided and distributed among the holders of the Common Stock ratably, except as may otherwise be provided in any such resolution or resolutions. Neither the merger or consolidation of the Corporation with another corporation nor the sale or lease of all or substantially all the assets of the Corporation shall be deemed to be a liquidation, dissolution, or winding up of the Corporation or a distribution of its assets.

Except as otherwise required by law or provided by a resolution or resolutions of the Board of Directors creating any series of Preferred Stock, the holders of Common Stock shall have the exclusive power to vote and shall have one vote in respect of each share of such stock held and the holders of Preferred Stock shall have no voting power whatsoever. Except as otherwise provided in such a resolution or resolutions, the authorized shares of any class or classes may be increased or decreased by the affirmative vote of the holders of a majority of the outstanding shares of stock of the Corporation entitled to vote.

FIFTH: The name and mailing address of each incorporator is as follows:

NAME	MAILING ADDRESS
Cornelius S. Van Rees	40 Wall Street, New York, NY 10005
Edward A. Bacon, Jr.	40 Wall Street, New York, NY 10005

SIXTH: Elections of directors need not be by written ballot unless the by-laws of the corporation shall so provide.

SEVENTH: The books of the corporations may be kept (subject to any provision contained in the statutes) outside the State of Delaware at such place or places as may be designated from time to time by the board of directors or in the by-laws of the corporation.

EIGHTH: Any or all of the Directors may be removed at any time, but only for cause, by the Shareholders at any meeting of Shareholders, called for the purpose, by the affirmative vote of 75% of the shares of the Corporation entitled to vote and, if a corporation, person or other entity owns more than 50% of the shares of the Corporation entitled to vote, by

the affirmative vote of the holders of a majority of the shares of the Corporation entitled to vote and not owned by the majority shareholder.

NINTH: The percentage of the votes cast at any meeting of shareholders that shall be necessary for the transaction of any business shall be as required by law and by the following provisions, and any purported shareholder action not in compliance herewith and any purported transaction not in compliance herewith, shall be void.

(a) Except as set forth in paragraph (b) of this Article NINTH:

- (i) any merger or consolidation of the Corporation with or into any other corporation;
- (ii) any sale, lease, exchange or other disposition of all or substantially all of the assets of the Corporation to or with any other corporation, person or other entity;
or
- (iii) the issuance or disposition by the Corporation of any of its securities to any other corporation, person or other entity in exchange for cash, securities or other assets, or a combination thereof

shall require the affirmative vote of the holders of

- (iv) 75% of the shares of the Corporation entitled to vote, and
- (v) a majority of the shares of the Corporation entitled to vote which are not owned by such other corporation, person or entity,

if, as of the record date for the determination of shareholders entitled to notice thereof and to vote thereon, such other corporation, person or entity which is a party to such transaction is the owner

of 5% or more of the shares of the Corporation entitled to vote. Such affirmative vote shall be required notwithstanding the fact that no vote may be required or that some lesser percentage may be specified by law or in any agreement with any national securities exchange.

(b) The provisions of paragraph (a) of this Article NINTH shall not apply to any transaction in which the Corporation and one or more subsidiaries of the Corporation are the only parties, nor to any other transaction described in clauses (i), (ii) or (iii) of paragraph (a) of this Article if

- (i) the Board of Directors of the Corporation shall have approved the transaction between the Corporation and the other corporation, person or entity with whom the transaction is proposed prior to the time such other corporation, person or entity shall have become the owner of 5% of the shares of the Corporation entitled to vote; or
- (ii) the transaction is approved prior to its consummation by the affirmative vote of two-thirds of the Directors who are not involved with or representing the corporation, person or entity with whom the transaction is proposed.

TENTH: The By-laws of the Corporation may not be amended except (a) by the Board of Directors, (b) by the Shareholders voting upon a proposal recommended by the affirmative vote of 75% of the entire Board of Directors, or (c) by the affirmative vote of (i) the holders of 75% of the shares of the Corporation entitled to vote and (ii) if any corporation, person, or other entity owns more than 50% of the shares of the Corporation entitled to vote, the

holders of a majority of the shares of the Corporation entitled to vote and not owned by the majority shareholder.

ELEVENTH: Unless recommended to the Shareholders by the affirmative vote of 75% of the entire Board of Directors, the affirmative vote of the holders of 75% of the shares of the Corporation entitled to vote shall be required for any amendment of this Certificate of Incorporation by the Shareholders, and, if a corporation, person or other entity owns more than 50% of the shares of the Corporation entitled to vote, such amendment shall also require the affirmative vote of the holders of a majority of the shares of the Corporation entitled to vote and not owned by the majority shareholder.

TWELFTH:

(a) The Board of Directors of the Corporation shall have the power and duty to determine, on the basis of information then known to it, (i) whether any corporation, person or other entity owns 5% or more of the shares of the Corporation entitled to vote, or is an "affiliate" or an "associate" (as defined below) of another, (ii) whether any proposed sale, lease, exchange, or other disposition of part of the assets of the Corporation involves substantially all of the assets of the Corporation, and (iii) whether any approval by Shareholders or Directors of the Corporation, purporting to comply with the requirements of

this Certificate of Incorporation, the By-Laws of the Corporation, or applicable law, is substantially consistent with the transaction to which it relates. Any such determination by the Board of Directors shall be conclusive and binding for all purposes of this Certificate of Incorporation.

- (b) For purposes of determining ownership of the Corporation's shares under Articles EIGHTH through TWELFTH of this Certificate of Incorporation,
- (i) a corporation, person or other entity shall be deemed to be the owner of any shares of the Corporation registered in its name on the books of the Corporation and of any shares of the Corporation (1) which it has the right to acquire pursuant to any agreements, or upon exercise of conversion rights, warrants or options or otherwise, or (2) which are beneficially owned, directly, or indirectly (including shares deemed owned through application of clause (1) above), by any other corporation, person or other entity (x) with which it or its "affiliate" or "associate" (as defined below) has any agreement, arrangement or understanding for the purpose of acquiring, holding, voting or disposing of shares of the Corporation or (y) which is its "affiliate" or "associate" as those terms were defined in rule 12b-2 of the General Rules and Regulations of the Securities Exchange Act of 1934 as in effect on March 25, 1976,
 - (ii) "shares of the Corporation entitled to vote" shall mean such shares as are entitled to vote generally in the election of Directors, considered as one class, and
-

- (iii) the shares of the Corporation entitled to vote shall include any shares deemed owned through the application of clauses (1) and (2) of paragraph (i) above but shall not include any other shares that may be issuable by the Corporation pursuant to any agreement, or upon the exercise of conversion rights, warrants, options, or otherwise.

THIRTEENTH: Whenever a compromise or arrangement is proposed between this corporation and its creditors or any class of them and/or between this corporation and its stockholders or any class of them, any court of equitable jurisdiction within the State of Delaware may, on the application in a summary way of this corporation or of any creditor or stockholder thereof or on the application of any receiver or receivers appointed for this corporation under the provisions of Section 291 of Title 8 of the Delaware Code or on the application of trustees in dissolution or of any receiver or receivers appointed for this corporation under the provisions of Section 279 of Title 8 of the Delaware Code order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this corporation, as the case may be, to be summoned in such manner as the said court directs. If a majority in number representing three-fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this corporation, as the case may be, agree to any compromise or arrangement and to any reorganization of this corporation as consequence of such compromise or arrangement and to any reorganization of this corporation as consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of this corporation, as the case may be, and also on this corporation.

WE, THE UNDERSIGNED, being each of the incorporators hereinbefore named, for the purpose of forming a corporation pursuant to the General Corporation Law of the State of Delaware, do make this certificate, hereby declaring and certifying that this is our act and deed and the facts herein stated are true, and accordingly have hereunto set our hands this 4th day of March, 1983

INCORPORATOR:

/s/ Cornelius S. Van Rees

(Signature)

Cornelius S. Van Rees
40 Wall Street
New York, New York 10005

INCORPORATOR:

/s/ Edward A. Bacon, Jr.

(Signature)

Edward A. Bacon, Jr.
40 Wall Street
New York, New York 10005

CERTIFICATE OF AMENDMENT
OF
RESTATED CERTIFICATE OF INCORPORATION

Graham Corporation, a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware, DOES HEREBY CERTIFY:

FIRST: That a meeting of the Board of Directors of Graham Corporation held on March 14, 1986, resolutions were duly adopted setting forth a proposed amendment to the Restated Certificate of Incorporation of said corporation, declaring said amendment to be advisable and calling a meeting of the stockholders of said corporation for consideration thereof. The resolution setting forth the proposed amendment is as follows:

RESOLVED, that the Restated Certificate of Incorporation of this corporation be amended by changing Article 4, paragraph 1 thereof so that, as amended said Article shall be and read as follows:

“The total number of shares of all classes of stock which the corporation shall have authority to issue is 3,500,000 shares, of which 500,000 shares shall be shares of Preferred Stock having a par value of \$1.00 each (hereinafter called Preferred Stock) and 3,000,000 shares shall be shares of Common Stock having a par value of \$0.10 each (hereinafter called Common Stock).”

SECOND: That thereafter, pursuant to resolution of its Board of Directors, an annual meeting of the stockholders of said corporation was duly called and held on May 27, 1986, upon notice in accordance with Section 222 of the General Corporation Law of the State of Delaware at which meeting the necessary number of shares as required by statute were voted in favor of the amendment.

THIRD: That said amendment was duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, said Graham Corporation has caused this certificate to be signed by Frederick D. Berkeley its Chairman of the Board of Directors, and attested by Cornelius S. Van Rees, its Secretary, this 1st day of July, 1986.

By: /s/ Frederick D. Berkeley
Chairman of the Board of Directors

ATTEST:

By: /s/ Cornelius S. Van Rees
Secretary

**CERTIFICATE OF AMENDMENT
OF
RESTATED CERTIFICATE OF INCORPORATION**

Graham Corporation, a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware, DOES HEREBY CERTIFY:

FIRST: That a meeting of the Board of Directors of Graham Corporation held on February 26, 1987, resolutions were duly adopted setting forth a proposed amendment to the Restated Certificate of Incorporation of said corporation, declaring said amendment to be advisable and calling a meeting of the stockholders of said corporation for consideration thereof. The resolution setting forth the proposed amendment is as follows:

RESOLVED, that the Restated Certificate of Incorporation of this corporation be amended by adding an Article Fourteen, said Article to be as follows:

FOURTEENTH

Section 1. To the fullest extent permitted by the Delaware General Corporation Law as the same exists or may hereafter be amended, a director of this corporation shall not be liable to the corporation or to any of its stockholders for monetary damages for breach of fiduciary duty as a director.

Any repeal or modification of the foregoing paragraph by the stockholders of the corporation shall not adversely affect any right or protection of a director of the corporation existing at the time of such repeal or modification.

Section 2. A director or officer of this corporation shall be indemnified by the corporation against any liabilities incurred in his capacity as a director or officer, such indemnification to include payment by the corporation of expenses incurred in defending a proceeding in advance of its final disposition, to the fullest extent permitted by the Delaware General Corporation Law or as may be provided by written agreement with the corporation.

The right to indemnification conferred in this Section, including the payment of expenses incurred in defending a proceeding in advance of its final disposition, shall not be exclusive of any other right which a director or officer may have or hereafter acquire under any statute, provision of the Certificate of Incorporation, by-law, agreement, vote of stockholders or disinterested directors or otherwise.

SECOND: That thereafter, pursuant to resolution of its Board of Directors, an annual meeting of the stockholders of said corporation was duly called and held on June 29, 1987, upon notice in accordance with Section 222 of the General Corporation Law of the State of Delaware at which meeting the necessary number of shares as required by statute were voted in favor of the amendment.

THIRD: That said amendment was duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, said Graham Corporation has caused this certificate to be signed by Frederick D. Berkeley, its Chairman of the Board of Directors, and attested by Cornelius S. Van Rees, its Secretary, this 20th day of July, 1987.

GRAHAM CORPORATION

By /s/ Frederick D. Berkeley
Frederick D. Berkeley
Chairman of the Board of Directors

ATTEST:

By: /s/ Cornelius S. Van Rees
Cornelius S. Van Rees
Secretary

CERTIFICATE FOR RENEWAL AND REVIVAL
OF
CERTIFICATE OF INCORPORATION
OF
GRAHAM CORPORATION

* * * * *

GRAHAM CORPORATION, a corporation organized under the laws of Delaware, the Certificate of Incorporation of which was filed in the office of the Secretary of State on the 7th day of March, 1983, the Certificate of Incorporation of which was voided for non-payment of taxes, now desires to procure a restoration, renewal and revival of its Certificate of Incorporation, and hereby certifies as follows:

1. The name of this corporation is

GRAHAM CORPORATION

2. Its registered office in the State of Delaware is located at Corporation Trust Center, 1209 Orange Street, City of Wilmington, County of New Castle and the name of its registered agent at such address is The Corporation Trust Company.

3. The date when the restoration, renewal, and revival of the Certificate of Incorporation of this company is to commence is the 29th day of February, 1988, same being prior to the date of the expiration of the Certificate of Incorporation. This renewal and revival of the Certificate of Incorporation of this corporation is to be perpetual.

4. This corporation was duly organized under the Laws of the State of Delaware and carried on the business authorized by its Certificate of Incorporation until the 1st day of March, 1988, at which time its Certificate of Incorporation became inoperative and void for non-

payment of taxes and this Certificate for Renewal and Revival is filed by authority of the duly elected directors of the corporation in accordance with the laws of the State of Delaware.

IN WITNESS WHEREOF, said GRAHAM CORPORATION, in compliance with Section 312 of Title 8 of the Delaware Code, has caused this Certificate to be signed by Alvin L. Snyder, its last and acting Vice President, and attested by Cornelius S. Van Rees, its last and acting Secretary, this thirtieth day of August, 1988.

GRAHAM CORPORATION

By /s/ Alvin L. Snyder
Its Last and Acting Vice President

ATTEST:

By: /s/ Cornelius S. Van Rees
Its Last and Acting Secretary

**CERTIFICATE OF AMENDMENT
OF RESTATED CERTIFICATE OF INCORPORATION OF
GRAHAM CORPORATION**

Graham Corporation, a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware, DOES HEREBY CERTIFY:

FIRST: That a meeting of the Board of Directors of Graham Corporation held on February 23, 1990, resolutions were duly adopted setting forth a proposed amendment to the Restated Certificate of Incorporation of said corporation, declaring said amendment to be advisable and calling a meeting of the stockholders of said corporation for consideration thereof. The resolution setting forth the proposed amendment is as follows:

RESOLVED, that the Restated Certificate of Incorporation of this corporation be amended by changing Article 4, paragraph 1 thereof so that, as amended said Article shall be and read as follows:

“The total number of shares of all classes of stock which the corporation shall have authority to issue is 6,500,000 shares, of which 500,000 shares shall be shares of Preferred Stock having a par value of \$1.00 each (hereafter called Preferred Stock) and 6,000,000 shares shall be shares of Common Stock having a par value of \$0.10 each (hereinafter called Common Stock).”

SECOND: That thereafter, pursuant to resolution of its Board of Directors, an annual meeting of the stockholders of said corporation was duly called and held on May 17, 1990 upon notice in accordance with Section 222 of the General Corporation Law of the State of Delaware at which meeting the necessary number of shares as required by statute were voted in favor of the amendment.

THIRD: That said amendment was duly adopted in accordance with the provisions of Section 242 of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, said Graham Corporation has caused this certificate to be signed by Frederick D. Berkeley, its Chairman of the Board of Directors, and attested by Cornelius S. Van Rees, its Secretary, this 17th day of May, 1990.

GRAHAM CORPORATION

By /s/ Frederick D. Berkeley
Frederick D. Berkeley
Chairman of the Board of Directors

ATTEST:

By: /s/ Cornelius S. Van Rees
Secretary

Seventh: The authorized capital stock of each foreign corporation which is a party to the merger is as follows:

<u>Corporation</u>	<u>Class</u>	<u>Number of Shares</u>	<u>Par Value per Share Or statement that shares are without par value</u>
Graham Manufacturing Co., Inc.	Common	1,000	\$ 0.10

Eighth: That this Certificate of Merger shall be effective on January 1, 1999.

Dated: December 22, 1998

GRAHAM CORPORATION

By /s/ A. Cadena
A. Cadena
President & Chief Executive Officer

**CERTIFICATE OF DESIGNATIONS, PREFERENCES AND RIGHTS OF SERIES A
JUNIOR PARTICIPATING PREFERRED STOCK OF GRAHAM CORPORATION**

Pursuant to Section 151 of the General Corporation Law of the State of Delaware

We, Alvaro Cadena, and Cornelius S. Van Rees, being the President and Chief Executive Officer and the Secretary, respectively, of **Graham Corporation**, a corporation organized and existing under the General Corporation Law of the State of Delaware (the "**Corporation**"), in accordance with the provisions of Sections 103 and 151 thereof, **Do Hereby Certify:**

That, pursuant to the authority conferred upon the board of directors of the Corporation (the "**Board**") by the Certificate of Incorporation of the Corporation, the Board at a meeting duly called and held on July 27, 2000, at which a quorum was present and acting throughout, duly adopted the following resolution creating a series of sixty thousand (60,000) shares of Preferred Stock, par value ONE DOLLAR (\$1.00) per share, designated "Series A Junior Participating Preferred Stock":

Resolved, that, pursuant to the authority vested in the Board in accordance with the provisions of its Certificate of Incorporation, a series of preferred stock of the Corporation to be designated "Series A Junior Participating Preferred Stock," par value ONE DOLLAR (\$1.00) per share (the "**Preferred Stock**"), be, and it hereby is, created, the designations and amount thereof and the voting powers, preferences and relative, participating, optional and other special rights of the shares of such series, and the qualifications, limitations and restrictions thereof, to be as follows:

SERIES A JUNIOR PARTICIPATING PREFERRED STOCK

SECTION 1. Designation and Amount. The shares of such series shall be designated as "Series A Junior Participating Preferred Stock," par value ONE DOLLAR (\$1.00) per share, and the number of shares constituting such series shall be sixty thousand (60,000). Such number of shares may be increased or decreased by resolution of the Board; provided, that no decrease shall reduce the number of shares of Series A Junior Participating Preferred Stock to a number less than the number of shares then outstanding plus the number of shares reserved for issuance upon the exercise of outstanding options, rights or warrants or upon the conversion of any outstanding securities issued by the Corporation convertible into Series A Junior Participating Preferred Stock.

SECTION 2. Dividends and Distributions.

Subject to the rights of the holders of any shares of any series of preferred stock (or any similar stock) ranking prior and superior to the Series A Junior Participating Preferred Stock with respect to dividends, the holders of shares of Series A Junior Participating Preferred Stock, in preference to the holders of Common Stock, par value TEN CENTS (\$0.10) per share (the "**Common Stock**"), of the Corporation, and of any other junior stock, shall be entitled to receive, when, as and if declared by the Board out of funds legally available for the purpose, quarterly dividends payable in cash on the first day of March, June, September and December in each **year (each such date being referred to herein as a "Quarterly Dividend Payment Date")**, commencing on the first Quarterly Dividend Payment Date after the first issuance of a share or fraction of a share of Series A Junior Participating Preferred Stock, in an amount per

share (rounded to the nearest cent) equal to the greater of (a) ONE DOLLAR (\$1.00) or (b) subject to the provision for adjustment hereinafter set forth, one hundred (100) times the aggregate per share amount of all cash dividends, and one hundred (100) times the aggregate per share amount (payable in kind) of all non-cash dividends or other distributions, other than a dividend payable in shares of Common Stock or a subdivision of the outstanding shares of Common Stock (by reclassification or otherwise), declared on the Common Stock since the immediately preceding Quarterly Dividend Payment Date or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of Series A Junior Participating Preferred Stock. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount to which holders of shares of Series A Junior Participating Preferred Stock were entitled immediately prior to such event under clause (b) of the preceding sentence shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(b) The Corporation shall declare a dividend or distribution on the Series A Junior Participating Preferred Stock as provided in paragraph (a) of this Section immediately after it declares a dividend or distribution on the Common Stock (other than a dividend payable in shares of Common Stock); provided, that in the event no dividend or distribution shall have been declared on the Common Stock during the period between any Quarterly Dividend Payment Date and the next subsequent Quarterly Dividend Payment Date, a dividend of ONE DOLLAR (\$1.00) per share on the Series A Junior Participating Preferred Stock shall nevertheless be payable on such subsequent Quarterly Dividend Payment Date.

(c) Dividends shall begin to accrue and be cumulative on outstanding shares of Series A Junior Participating Preferred Stock from the Quarterly Dividend Payment Date next preceding the date of issue of such shares, unless the date of issue of such shares is prior to the record date for the first Quarterly Dividend Payment Date, in which case dividends on such shares shall begin to accrue from the date of issue of such shares, or unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of shares of Series A Junior Participating Preferred Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from such Quarterly Dividend Payment Date. Accrued but unpaid dividends shall not bear interest. Dividends paid on the shares of Series A Junior Participating Preferred Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding. The Board may fix a record date for the determination of holders of shares of Series A Junior Participating Preferred Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be not more than sixty (60) days prior to the date fixed for the payment thereof.

SECTION 3. Voting Rights. The holders of shares of Series A Junior Participating Preferred Stock shall have the following voting rights:

(a) Subject to the provision for adjustment hereinafter set forth, each share of Series A Junior Participating Preferred Stock shall entitle the holder thereof to one hundred (100) votes on all matters submitted to a vote of the stockholders of the Corporation. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the number of votes per share to which holders of shares of Series A Junior Participating Preferred Stock were entitled immediately prior to such event shall be adjusted by multiplying such number by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(b) Except as otherwise provided herein, in any other resolution creating a series of preferred stock or any similar stock, in any amendment to the Certificate of Incorporation of the Corporation or bylaw, the holders of shares of Series A Junior Participating Preferred Stock and the holders of shares of Common Stock and any other capital stock of the Corporation having general voting rights shall vote together as one class on all matters submitted to a vote of stockholders of the Corporation.

(c) Except as set forth herein, or as otherwise provided by law, holders of Series A Junior Participating Preferred Stock shall have no special voting rights and their consent shall not be required (except to the extent they are entitled to vote with holders of Common Stock as set forth herein) for taking any corporate action.

SECTION 4. Certain Restrictions.

(a) Whenever quarterly dividends or other dividends or distributions payable on the Series A Junior Participating Preferred Stock as provided in Section 2 are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series A Junior Participating Preferred Stock outstanding shall have been paid in full, the Corporation shall not:

(i) declare or pay dividends, or make any other distributions, on any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Junior Participating Preferred Stock;

(ii) declare or pay dividends, or make any other distributions, on any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Junior Participating Preferred Stock, except dividends paid ratably on the Series A Junior Participating Preferred Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled;

(iii) redeem or purchase or otherwise acquire for consideration shares of any stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Junior Participating Preferred Stock, provided that the Corporation may at any time redeem, purchase or otherwise acquire shares of any such junior stock in exchange for shares of any stock of the Corporation ranking junior (either as to dividends or upon dissolution, liquidation or winding up) to the Series A Junior Participating Preferred Stock; or

(iv) redeem or purchase or otherwise acquire for consideration any shares of Series A Junior Participating Preferred Stock, or any shares of stock ranking on a parity with the Series A Junior Participating Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board) to all holders of such shares upon such terms as the Board, after consideration of the respective annual dividend rates and other relative rights and preferences of the respective series and classes, shall determine in good faith will result in fair and equitable treatment among the respective series or classes.

(b) The Corporation shall not permit any subsidiary of the Corporation to purchase or otherwise acquire for consideration any shares of stock of the Corporation unless the Corporation could, under paragraph (a) of this Section 4, purchase or otherwise acquire such shares at such time and in such manner.

SECTION 5. Reacquired Shares. Any shares of Series A Junior Participating Preferred Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof. All such shares shall upon their cancellation become authorized but unissued shares of preferred stock and may be reissued as part of a new series of preferred stock subject to the conditions and restrictions on issuance set forth herein, in a resolution of the Board, in the Certificate of Incorporation of the Corporation, or in any other Certificate of Amendment creating a series of preferred stock or any similar stock or as otherwise required by law.

SECTION 6. Liquidation, Dissolution or Winding Up. Upon any liquidation, dissolution or winding up of the Corporation, no distribution shall be made (a) to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Junior Participating Preferred Stock unless, prior thereto, the holders of shares of Series A Junior Participating Preferred Stock shall have received the greater of (i) ONE HUNDRED DOLLARS (\$100.00) per share, plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment, or (ii) an aggregate amount per share, subject to the provision for adjustment hereinafter set forth, equal to one hundred (100) times the aggregate amount to be distributed per share to holders of shares of Common Stock, or (b) to the holders of shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Junior Participating Preferred Stock, except distributions made ratably on the Series A Junior Participating Preferred Stock and all such parity stock in proportion to the total amounts to which the holders of all such shares are entitled upon such liquidation, dissolution or winding up. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the aggregate amount to which holders of shares of Series A Junior Participating Preferred Stock were entitled immediately prior to such event under the provision in clause (a) of the preceding sentence shall be adjusted by multiplying such amount by a fraction, the numerator of

which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

SECTION 7. Consolidation, Merger, Etc. In case the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case each share of Series A Junior Participating Preferred Stock shall at the same time be similarly exchanged or changed into an amount per share, subject to the provision for adjustment hereinafter set forth, equal to one hundred (100) times the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision or combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount set forth in the preceding sentence with respect to the exchange or change of shares of Series A Junior Participating Preferred Stock shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

SECTION 8. No Redemption. The shares of Series A Junior Participating Preferred Stock shall not be redeemable, except as otherwise provided herein.

SECTION 9. Rank. The Series A Junior Participating Preferred Stock shall rank, with respect to the payment of dividends and the distribution of assets, junior to all other series of the Corporation's preferred stock.

SECTION 10. Amendment. At any time that any shares of Series A Preferred Stock are outstanding, the Certificate of Incorporation of the Corporation shall not be amended in any manner, nor shall the Board take any action, which would materially alter or change the powers, preferences or special rights of the Series A Junior Participating Preferred Stock so as to affect them adversely without the affirmative vote of the holders of at least three-fourths (3/4) of the outstanding shares of Series A Junior Participating Preferred Stock, voting together as a single class.

SECTION 11. Fractional Shares. Series A Junior Participating Preferred Stock may be issued in fractions of a share, which shall entitle the holder, in proportion to such holder's fractional shares, to exercise voting rights, receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series A Junior Participating Preferred Stock.

In Witness Whereof, Graham Corporation has caused this certificate to be executed by its President and Chief Executive Officer and by its Secretary this 29th day of August, 2000.

Graham Corporation

By: /s/ Alvaro Cadena

Name: Alvaro Cadena

Title: President and Chief Executive Officer

By: /s/ Cornelius S. Van Rees

Name: Cornelius S. Van Rees

Title: Secretary

**CERTIFICATE OF AMENDMENT
TO
THE CERTIFICATE OF INCORPORATION
OF
GRAHAM CORPORATION**

Pursuant to Section 242 of the General Corporation Law of the State of Delaware, Graham Corporation, a corporation organized and existing under and by virtue of the General Corporation Law of the State of Delaware, **DOES HEREBY CERTIFY:**

FIRST: That the Board of Directors of said corporation, at a meeting duly convened and held on May 29, 2008, adopted a resolution proposing and declaring advisable the following amendment to the Certificate of Incorporation of said corporation:

RESOLVED, that the Certificate of Incorporation of Graham Corporation be amended by restating the Fourth Article so that, as amended, said Article shall read as follows:

“The total number of shares of all classes of stock which the corporation shall have authority to issue is 26,000,000 shares, of which 500,000 shares shall be shares of Preferred Stock having a par value of \$1.00 each (hereafter called Preferred Stock) and 25,500,000 shares shall be shares of Common Stock having a par value of \$0.10 each (hereinafter called Common Stock).”

SECOND: That such amendment has been duly adopted by the affirmative vote of the holders of a majority of the stock entitled to vote at the annual meeting of stockholders in accordance with the provisions of the General Corporation Law of the State of Delaware.

IN WITNESS WHEREOF, the above mentioned corporation has caused this certificate to be signed by James R. Lines, its President and Chief Executive Officer, this 31st day of July, 2008.

By: /s/ James R. Lines
James R. Lines, President and Chief
Executive Officer

FORM OF
NON-QUALIFIED STOCK OPTION AGREEMENT (Directors)

This NON-QUALIFIED STOCK OPTION AGREEMENT ("Agreement") is made and entered into as of the ____ day of _____, by and between Graham Corporation, a corporation organized and existing under the laws of the State of Delaware and having an office at 20 Florence Avenue, Batavia, New York 14020 ("Company") and _____ ("Option Holder").

WITNESSETH:

WHEREAS, by action of its Board of Directors ("Board"), the Company has adopted the 2000 Graham Corporation Incentive Plan to Increase Shareholder Value ("Plan"), pursuant to which Non-Qualified Stock Options with respect to shares of common stock of the Company ("Shares") may be granted to the Company's eligible officers, employees and directors; and

WHEREAS, pursuant to Article III of the Plan, a Compensation Committee ("Committee") has been appointed to select the individuals to whom Non-Qualified Stock Options shall be granted and to prescribe the terms and conditions of such grants; and

WHEREAS, the Committee has determined that the Option Holder is eligible to be granted a Non-Qualified Stock Option and desires to grant a Non-Qualified Stock Option to the Option Holder, and the Option Holder desires to accept such grant, on the terms and conditions hereinafter set forth;

NOW, THEREFORE, the Company and the Option Holder hereby agree as follows:

Section 1. Grant of Non-Qualified Stock Option. The Company hereby grants, and the Option Holder hereby accepts the Company's grant of, a Non-Qualified Stock Option to purchase _____ Shares ("Optioned Shares"), on the terms and conditions hereinafter set forth.

Section 2. Option Period. Subject to the vesting and other limitations contained in Section 4, elsewhere in this Option Agreement and in the Plan, the Option Holder shall have the right to purchase all or any portion of the vested Optioned Shares at any time during a period ("Option Period") which shall commence on the date six months and one day following the date first above written and shall end on the earliest to occur of the following dates:

(a) the last day of the one-year period commencing on the date the Eligible Outside Director ceases to be a member of the Board for reasons other than on account of death, Disability or retirement as a member of the Board after age 65;

(b) the last day of the three-year period commencing on the date the Eligible Outside Director ceases to be a member of the Board on account of death, Disability or retirement as a member of the Board after age 65; or

(c) the last day of the ten year period commencing on the date on which the Option was granted.

Section 3. Exercise Price. The Option Holder shall have the right to purchase all or any portion of the vested Optioned Shares at a price per Share equal to \$ _____ (“Exercise Price”) payable (a) in United States dollars in cash or by certified check, money order or bank draft payable to the order of Graham Corporation, (b) in Shares duly endorsed for transfer and with all necessary stock transfer tax stamps attached, already owned by the Option Holder and having a fair market value equal to the Exercise Price, such fair market value to be determined in such manner as may be provided by the Committee or as may be required in order to comply with or conform to the requirements of any applicable laws or regulations, or (c) in a combination of United States dollars and such Shares.

Section 4. Vesting; Limitations on Exercise.

(a) The shares underlying this Option shall vest and become exercisable 25 percent per year, commencing one year following the date this Option was granted to the Option Holder (e.g., if this Option is for an aggregate of 2,000 shares, 500 of such shares shall vest and become exercisable one year following the date of this Option, 500 of such shares shall vest and become exercisable two years following the date of this Option, 500 of such shares shall vest and become exercisable three years following the date of this Option and 500 of such shares shall vest and become exercisable four years following the date of this Option). Except as otherwise provided by Section 4(b), upon the Option Holder ceasing to be a member of the Company’s Board of Directors, Optioned Shares which have not previously vested shall not thereafter vest or become exercisable under the Option. In addition, shares underlying this Option and this Option itself shall be subject to Section 2 and as well as to all other requirements imposed by applicable laws, rules or regulations.

(b) Notwithstanding Section 4(a), the Option shall immediately vest and become exercisable with respect to all Optioned Shares upon the death, Disability or Retirement of the Option Holder. For purposes of this Agreement, “Retirement” shall mean a voluntary separation from service by an Option Holder who is at least age 60 and who has been a member of the Company’s Board of Directors for ten or more years.

Section 5. Method of Exercise. The Option Holder may, at any time during the Option Period, exercise his right to purchase all or any part of the Optioned Shares then available for purchase; provided, however, that the minimum number of Optioned Shares which may be purchased shall be one hundred (100) or, if less, the total number of Optioned Shares then available for purchase. The Option Holder shall exercise such right by:

(a) giving written notice to the Compensation Committee of the Board of Directors of Graham Corporation (“Committee”), in the form attached hereto as Exhibit A with such form completed and delivered to the Company’s Chief Accounting Officer; and

(b) delivering to the Committee full payment of the Exercise Price for the Optioned Shares to be purchased.

As soon as is practicable following the date on which the Option Holder has satisfied the requirements of this section 5, the Committee shall take such action as is necessary to cause the Company to issue a stock certificate evidencing the Option Holder's ownership (or the ownership of such other person as the Option Holder may, by written notice to the Committee, designate) of the Optioned Shares that have been purchased. The Option Holder or other person shall have no right to vote or to receive dividends, nor have any other rights with respect to Optioned Shares, prior to the date as of which such Optioned Shares are transferred to him on the stock transfer records of the Company, and no adjustments shall be made for any dividends or other rights for which the record date is prior to the date as of which such transfer is effected, except as may be required under Section 8.

Section 6. Registration and Delivery of Optioned Shares. The Company's obligation to deliver Shares under this Agreement shall, if the Committee so requests, be conditioned upon the receipt of a representation as to the investment intention of the Option Holder to whom such Shares are to be delivered, in such form as the Committee shall determine to be necessary or advisable to comply with the provisions of applicable federal, state or local law. It may be provided that any such representation shall become inoperative upon a registration of the Shares or upon the occurrence of any other event eliminating the necessity of such representation. The Company shall not be required to deliver any Shares under this Agreement prior to (a) the admission of such Shares to listing on any stock exchange on which Shares may then be listed, or (b) the completion of such registration or other qualification under any state or federal law, rule or regulations as the Committee shall determine to be necessary or advisable.

Section 7. Effect of Exercise of Appreciation Right. In the event that the Option Holder shall be granted an Appreciation Right with respect to all or any portion of the Optioned Shares, the exercise of such Appreciation Right shall automatically result in a reduction of the number of Optioned Shares available for purchase hereunder by the number of Shares as to which such Appreciation Right is exercised.

Section 8. Adjustments in the Event of Reorganization

(a) In the event of any merger, consolidation, or other business reorganization in which the Company is the surviving entity, and in the event of any stock split, stock dividend or other event generally affecting the number of Shares held by each person who is then a shareholder of record, the number of Optioned Shares shall be adjusted to account for such event. Such adjustment shall be effected by multiplying:

(i) such number of Optioned Shares by

(ii) an amount equal to the number of Shares that would be owned after such event by a person who, immediately prior to such event, was the holder of record of one Share;

and the Exercise Price shall be adjusted by dividing the Exercise Price by the amount determined under section 8(a)(ii); provided, however, that the Committee may, in its discretion, establish another appropriate method of adjustment.

(b) In the event of any merger, consolidation, or other business reorganization in which the Company is not the surviving entity:

(i) Any Non-Qualified Stock Options granted under this Agreement that remain outstanding may be canceled by the Board upon at least thirty days' written notice to each Option Holder in advance of the effective date of such merger, consolidation, business reorganization, liquidation or sale; and

(ii) Any Non-Qualified Stock Option which is not canceled pursuant to section 8(b)(i) shall be adjusted in such manner as the Committee shall deem appropriate to account for such merger, consolidation or other business reorganization.

Section 9. No Right to Continued Board Membership. Nothing in this Agreement, nor any action of the Board or Committee with respect to this Agreement, shall be held or construed to confer upon the Option Holder any right to a continuation of membership on the Board of the Company or any of its affiliates. The Option Holder may be dealt with in the same manner as if this Agreement had not been entered into.

Section 10. Taxes. Where any person is entitled to receive Shares pursuant to the exercise of the Non-Qualified Stock Option granted hereunder, the Company shall have the right to require such person to pay to the Company the amount of any tax which the Company is required to withhold with respect to such Shares, or, in lieu thereof, to retain, or to sell without notice, a sufficient number of Shares to cover the amount required to be withheld.

Section 11. No Assignment. The Non-Qualified Stock Option granted hereunder shall not be subject in any manner to anticipation, alienation or assignment, nor shall such Non-Qualified Stock Option be liable for or subject to debts, contracts, liabilities, engagements or torts, nor shall it be transferable by the Option Holder other than by will or by the laws of descent and distribution. During the lifetime of the Option Holder, the Non-Qualified Stock Option granted hereunder shall be exercisable only by him.

Section 12. Notices. Any communication required or permitted to be given under the Plan, including any notice, direction, designation, comment, instruction, objection or waiver, shall be in writing and shall be deemed to have been given at such time as it is delivered personally or five (5) days after mailing if mailed, postage prepaid, by registered or certified mail, return receipt requested, addressed to such party at the address listed below, or at such other address as one such party may by written notice specify to the other party:

(a) If to the Committee:

Graham Corporation
20 Florence Avenue
Batavia, New York 14020
Attention: Chief Accounting Officer

(b) If to the Option Holder, to the Option Holder's then current residential address.

Section 13. Successors and Assigns. This Agreement shall inure to the benefit of and shall be binding upon the Company and the Option Holder and their respective heirs, successors and assigns.

Section 14. Construction of Language. Whenever appropriate in the Agreement, words used in the singular may be read in the plural, words used in the plural may be read in the singular, and words importing the masculine gender may be read as referring equally to the feminine or the neuter. Any reference to a section shall be a reference to a section of this Agreement, unless the context clearly indicates otherwise. Capitalized terms not specifically defined herein shall have the meanings assigned to them under the Plan.

Section 15. Governing Law. This Agreement shall be construed, administered and enforced according to the laws of the State of New York without giving effect to the conflict of laws principles thereof, except to the extent that such laws are preempted by federal law.

Section 16. Amendment. This Agreement may be amended, in whole or in part and in any manner not inconsistent with the provisions of the Plan, at any time and from time to time by written agreement between the Company and the Option Holder.

Section 17. Plan Provisions Control. This Agreement and the rights and obligations created hereunder shall be subject to all of the terms and conditions of the Plan. In the event of any conflict between the provisions of the Plan and the provisions of this Agreement, the terms of the Plan, which are incorporated herein by reference, shall control. By signing this Agreement, the Option Holder acknowledges receipt of a copy of the Plan.

Section 18. Acceptance by Option Holder. By executing this Agreement and returning a fully executed copy hereof to the Committee at the address specified in section 12, the Option Holder signifies his acceptance of the terms and conditions of this Non-Qualified Stock Option. If a fully executed copy of this Agreement is not received by the Committee within forty-five days after the date when it is presented to the Option Holder, the Committee may revoke the Non-Qualified Stock Option granted, and thereby avoid all obligations, hereunder.

IN WITNESS WHEREOF, the Option Holder has executed, and the Company has caused its duly authorized representative to execute, this Agreement as of the date first above written.

GRAHAM CORPORATION

By: _____
James R. Lines
President and Chief Executive Officer

Date: _____

ATTEST:

Assistant Secretary

[SEAL]

OPTION HOLDER:

Name:

Date: _____

Exhibit A to Non-Qualified Stock Option Agreement (Directors)

2000 Graham Corporation Incentive Plan to Increase Shareholder Value

Instructions. Use this Notice to inform the Compensation Committee of Graham Corporation (“Company”) that you are exercising your right to purchase shares of common stock (“Shares”) of the Company pursuant to a non-qualified stock option (“Option”) granted under the 2000 Graham Corporation Incentive Plan to Increase Shareholder Value (“Plan”). If you are not the person to whom the Option was granted (“Option Holder”), you must attach to this Notice proof of your right to exercise the Option granted under the Non-Qualified Stock Option Agreement entered into between the Company and the Option Holder (“Agreement”). This Notice should be personally delivered or mailed by certified mail, return receipt requested, to: Compensation Committee, Graham Corporation, 20 Florence Avenue, Batavia, New York 14020, Attention: Chief Accounting Officer. The effective date of the exercise of the Option shall be the date this Notice is personally delivered or post marked by the United States Post Office if mailed. Except as specifically provided to the contrary herein, capitalized terms shall have the meanings assigned to them under the Plan. This Notice is subject to all of the terms and conditions of the Plan and the Agreement.

Graham Corporation
20 Florence Avenue
Batavia, NY 14020

Attention: Chief Accounting Officer

Re: **Notice of Exercise of Non-Qualified Stock Option (Directors)**

Dear Sirs:

This shall constitute my irrevocable direction and authorization to exercise options with respect to _____ shares of Graham Corporation stock previously granted to me under the 2000 Graham Corporation Incentive Plan to Increase Shareholder Value (“Plan”) at \$_____ per share. I further authorize you to issue my shares in my name and deliver them to _____ (“Broker”) for my account.

By copy of this letter, I authorize the Broker to issue a check from my account maintained with the Broker payable to Graham Corporation in the amount of \$_____.

I represent that the above shares are not subject to any encumbrance or other claim and that you, the Broker, and Graham Corporation’s transfer agent (“Transfer Agent”) may rely upon this exercise notice as a representation and authorization for this purpose.

By copy of this letter, I further authorize the Broker to:

- Exercise and Sell
 - Exercise and Hold
-

You are hereby directed and instructed to issue _____ shares of common stock in my name for my account maintained with the Broker. Please:

- (a) Arrange for electronic transfer of the shares on this date via the Depository Trust to the Broker, whose DTC Number is _____; **or**
- (b) Expedite the overnight delivery of said certificate by express mail to:

Broker Name _____

Address _____

I understand that the difference between the Fair Market Value of the Shares to be issued to me pursuant to this Notice and the Exercise Price of such Shares will be taxable income to me, and that I must consult with my own tax advisor regarding when such income will be reportable. I understand that, under the Plan and Agreement, I am responsible for the amount of any federal, state and local taxes that are required to be paid with respect to the Shares to be issued pursuant to this Notice.

I have been advised by my legal counsel that my acquisition of shares pursuant to this notice and my sale of the shares so acquired is not a transaction to which Section 16(b) of the Securities Exchange Act of 1934 ("short swing profit rule") applies. I acknowledge that under the short swing profit rule I may be liable to the Corporation in the event of a sale occasioned by a margin deficiency in my account.

I understand that I must rely on, and consult with, my own legal counsel (and not the Company) regarding the application of all laws — particularly tax and securities laws — to the transactions to be effected pursuant to this Notice.

Date _____

[Name]

Address

ON BEHALF OF THE COMMITTEE

Received [check one]:

By Hand

By Mail Post Marked

Date of Post Mark

By

Authorized Signature

Date of Receipt

FORM OF
NON-QUALIFIED STOCK OPTION AGREEMENT (Employees)

This NON-QUALIFIED STOCK OPTION AGREEMENT ("Agreement") is made and entered into as of the ____ day of _____, by and between Graham Corporation, a corporation organized and existing under the laws of the State of Delaware and having an office at 20 Florence Avenue, Batavia, New York 14020 ("Company") and _____ ("Option Holder").

WITNESSETH

WHEREAS, by action of its Board of Directors ("Board"), the Company has adopted the 2000 Graham Corporation Incentive Plan to Increase Shareholder Value ("Plan"), pursuant to which Non-Qualified Stock Options with respect to shares of common stock of the Company ("Shares") may be granted to the Company's eligible officers and employees; and

WHEREAS, pursuant to Article III of the Plan, a Compensation Committee ("Committee") has been appointed to select the individuals to whom Non-Qualified Stock Options shall be granted and to prescribe the terms and conditions of such grants; and

WHEREAS, the Committee has determined that the Option Holder is eligible to be granted a Non-Qualified Stock Option and desires to grant a Non-Qualified Stock Option to the Option Holder, and the Option Holder desires to accept such grant, on the terms and conditions hereinafter set forth;

NOW, THEREFORE, the Company and the Option Holder hereby agree as follows:

Section 1. Grant of Non-Qualified Stock Option. The Company hereby grants, and the Option Holder hereby accepts the Company's grant of, a Non-Qualified Stock Option to purchase _____ Shares ("Optioned Shares"), on the terms and conditions hereinafter set forth.

Section 2. Option Period. Subject to the vesting and other limitations contained in Section 4, elsewhere in this Option Agreement and in the Plan, the Option Holder shall have the right to purchase all or any portion of the Optioned Shares at any time during a period ("Option Period") which shall commence on the date six months and one day following the date first above written and shall end on the earliest to occur of the following dates:

- (a) the tenth anniversary of the date first above written;
 - (b) the third anniversary of the Option Holder's termination of employment with the Company due to his death, Disability or retirement; and
 - (c) the first anniversary of the date of the Option Holder's termination of employment with the Company for any reason not described in section 2(b).
-

Section 3. Exercise Price. The Option Holder shall have the right to purchase all or any portion of the vested Optioned Shares at a price per Share equal to \$ _____ (“Exercise Price”) payable (a) in United States dollars in cash or by certified check, money order or bank draft payable to the order of Graham Corporation, (b) in Shares duly endorsed for transfer and with all necessary stock transfer tax stamps attached, already owned by the Option Holder and having a fair market value equal to the Exercise Price, such fair market value to be determined in such manner as may be provided by the Committee or as may be required in order to comply with or conform to the requirements of any applicable laws or regulations, or (c) in a combination of United States dollars and such Shares.

Section 4. Vesting; Limitations on Exercise.

(a) The shares underlying this Option shall vest and become exercisable 25 percent per year, commencing one year following the date this Option was granted to the Option Holder (e.g., if this Option is for an aggregate of 6,000 shares, 1,500 of such shares shall vest and become exercisable one year following the date of this Option, 1,500 of such shares shall vest and become exercisable two years following the date of this Option, 1,500 of such shares shall vest and become exercisable three years following the date of this Option and 1,500 of such shares shall vest and become exercisable four years following the date of this Option). Except as otherwise provided by Section 4(b), upon the Option Holder ceasing to be an employee of the Company, Optioned Shares which have not previously vested shall not thereafter vest or become exercisable under the Option. In addition, shares underlying this Option and this Option itself shall be subject to Section 2 and as well as to all other requirements imposed by applicable laws, rules or regulations.

(b) Notwithstanding Section 4(a), the Option shall immediately vest and become exercisable with respect to all Optioned Shares upon the death, Disability or Retirement of the Option Holder. For purposes of this Agreement, “Retirement” shall mean a voluntary separation from service by an Option Holder who is at least age 60 and who has been employed by the Company on a full-time basis for ten or more years.

Section 5. Method of Exercise. The Option Holder may, at any time during the Option Period, exercise his right to purchase all or any part of the Optioned Shares then available for purchase; provided, however, that the minimum number of Optioned Shares which may be purchased shall be one hundred (100) or, if less, the total number of Optioned Shares then available for purchase. The Option Holder shall exercise such right by:

(a) giving written notice to the Compensation Committee of the Board of Directors of Graham Corporation (the “Committee”), in the form attached hereto as Exhibit A with such form completed and delivered to the Company’s Chief Accounting Officer; and

(b) delivering to the Committee full payment of the Exercise Price for the Optioned Shares to be purchased.

As soon as is practicable following the date on which the Option Holder has satisfied the requirements of this section 5, the Committee shall take such action as is necessary to cause the Company to issue a stock certificate evidencing the Option Holder’s ownership (or the ownership of such other person as the Option Holder may, by written notice to the Committee, designate) of the

Optioned Shares that have been purchased. The Option Holder or other person shall have no right to vote or to receive dividends, nor have any other rights with respect to Optioned Shares, prior to the date as of which such Optioned Shares are transferred to him on the stock transfer records of the Company, and no adjustments shall be made for any dividends or other rights for which the record date is prior to the date as of which such transfer is effected, except as may be required under section 8.

Section 6. Registration and Delivery of Optioned Shares. The Company's obligation to deliver Shares under this Agreement shall, if the Committee so requests, be conditioned upon the receipt of a representation as to the investment intention of the Option Holder to whom such Shares are to be delivered, in such form as the Committee shall determine to be necessary or advisable to comply with the provisions of applicable federal, state or local law. It may be provided that any such representation shall become inoperative upon a registration of the Shares or upon the occurrence of any other event eliminating the necessity of such representation. The Company shall not be required to deliver any Shares under this Agreement prior to (a) the admission of such Shares to listing on any stock exchange on which Shares may then be listed, or (b) the completion of such registration or other qualification under any state or federal law, rule or regulations as the Committee shall determine to be necessary or advisable.

Section 7. Effect of Exercise of Appreciation Right. In the event that the Option Holder shall be granted an Appreciation Right with respect to all or any portion of the Optioned Shares, the exercise of such Appreciation Right shall automatically result in a reduction of the number of Optioned Shares available for purchase hereunder by the number of Shares as to which such Appreciation Right is exercised.

Section 8. Adjustments in the Event of Reorganization

(a) In the event of any merger, consolidation, or other business reorganization in which the Company is the surviving entity, and in the event of any stock split, stock dividend or other event generally affecting the number of Shares held by each person who is then a shareholder of record, the number of Optioned Shares shall be adjusted to account for such event. Such adjustment shall be effected by multiplying:

(i) such number of Optioned Shares by

(ii) an amount equal to the number of Shares that would be owned after such event by a person who, immediately prior to such event, was the holder of record of one Share;

and the Exercise Price shall be adjusted by dividing the Exercise Price by the amount determined under section 8(a)(ii); provided, however, that the Committee may, in its discretion, establish another appropriate method of adjustment.

(b) In the event of any merger, consolidation, or other business reorganization in which the Company is not the surviving entity:

(i) Any Non-Qualified Stock Options granted under this Agreement that remain outstanding may be canceled by the Board upon at least thirty days' written notice to each

Option Holder in advance of the effective date of such merger, consolidation, business reorganization, liquidation or sale; and

(ii) Any Non-Qualified Stock Option which is not canceled pursuant to section 8(b)(i) shall be adjusted in such manner as the Committee shall deem appropriate to account for such merger, consolidation or other business reorganization.

Section 9. No Right to Continued Employment. Nothing in this Agreement nor any action of the Board or Committee with respect to this Agreement shall be held or construed to confer upon the Option Holder any right to a continuation of employment by the Company or any of its affiliates which employ the Option Holder. The Option Holder may be dismissed or otherwise dealt with as though this Agreement had not been entered into.

Section 10. Taxes. Where any person is entitled to receive Shares pursuant to the exercise of the Non-Qualified Stock Option granted hereunder, the Company shall have the right to require such person to pay to the Company the amount of any tax which the Company is required to withhold with respect to such Shares, or, in lieu thereof, to retain, or to sell without notice, a sufficient number of Shares to cover the amount required to be withheld.

Section 11. No Assignment. The Non-Qualified Stock Option granted hereunder shall not be subject in any manner to anticipation, alienation or assignment, nor shall such Non-Qualified Stock Option be liable for or subject to debts, contracts, liabilities, engagements or torts, nor shall it be transferable by the Option Holder other than by will or by the laws of descent and distribution. During the lifetime of the Option Holder, the Non-Qualified Stock Option granted hereunder shall be exercisable only by him.

Section 12. Notices. Any communication required or permitted to be given under the Plan, including any notice, direction, designation, comment, instruction, objection or waiver, shall be in writing and shall be deemed to have been given at such time as it is delivered personally or five (5) days after mailing if mailed, postage prepaid, by registered or certified mail, return receipt requested, addressed to such party at the address listed below, or at such other address as one such party may by written notice specify to the other party:

(a) If to the Committee:

Graham Corporation
20 Florence Avenue
Batavia, New York 14020
Attention: Chief Accounting Officer

(b) If to the Option Holder, to the Option Holder's then current residential address.

Section 13. Successors and Assigns. This Agreement shall inure to the benefit of and shall be binding upon the Company and the Option Holder and their respective heirs, successors and assigns.

Section 14. Construction of Language. Whenever appropriate in the Agreement, words used in the singular may be read in the plural, words used in the plural may be read in the singular, and words importing the masculine gender may be read as referring equally to the feminine or the neuter. Any reference to a section shall be a reference to a section of this Agreement, unless the context clearly indicates otherwise. Capitalized terms not specifically defined herein shall have the meanings assigned to them under the Plan.

Section 15. Governing Law. This Agreement shall be construed, administered and enforced according to the laws of the State of New York without giving effect to the conflict of laws principles thereof, except to the extent that such laws are preempted by the federal law.

Section 16. Amendment. This Agreement may be amended, in whole or in part and in any manner not inconsistent with the provisions of the Plan, at any time and from time to time by written agreement between the Company and the Option Holder.

Section 17. Plan Provisions Control. This Agreement and the rights and obligations created hereunder shall be subject to all of the terms and conditions of the Plan. In the event of any conflict between the provisions of the Plan and the provisions of this Agreement, the terms of the Plan, which are incorporated herein by reference, shall control. By signing this Agreement, the Option Holder acknowledges receipt of a copy of the Plan.

Section 18. Acceptance by Option Holder. By executing this Agreement and returning a fully executed copy hereof to the Committee at the address specified in section 13, the Option Holder signifies his acceptance of the terms and conditions of this Non-Qualified Stock Option. If a fully executed copy of this Agreement is not received by the Committee within forty-five (45) days after the date when it is presented to the Option Holder, the Committee may revoke the Non-Qualified Stock Option granted, and thereby avoid all obligations, hereunder.

IN WITNESS WHEREOF, the Option Holder has executed, and the Company has caused its duly authorized representative to execute, this Agreement as of the date first above written.

GRAHAM CORPORATION

By: _____
James R. Lines
President and Chief Executive Officer

ATTEST:

Assistant Secretary

[SEAL]

OPTION HOLDER: _____

Date: _____

Exhibit A to Non-Qualified Stock Option Agreement (Employees)

2000 Graham Corporation Incentive Plan to Increase Shareholder Value

Instructions. Use this Notice to inform the Compensation Committee of Graham Corporation (“Company”) that you are exercising your right to purchase shares of common stock (“Shares”) of the Company pursuant to a non-qualified stock option (“Option”) granted under the 2000 Graham Corporation Incentive Plan to Increase Shareholder Value (“Plan”). If you are not the person to whom the Option was granted (“Option Holder”), you must attach to this Notice proof of your right to exercise the Option granted under the Non-Qualified Stock Option Agreement entered into between the Company and the Option Holder (“Agreement”). This Notice should be personally delivered or mailed by certified mail, return receipt requested, to: Compensation Committee, Graham Corporation, 20 Florence Avenue, Batavia, New York 14020, Attention: Chief Accounting Officer. The effective date of the exercise of the Option shall be the date this Notice is personally delivered or post marked by the United States Post Office if mailed. Except as specifically provided to the contrary herein, capitalized terms shall have the meanings assigned to them under the Plan. This Notice is subject to all of the terms and conditions of the Plan and the Agreement.

Graham Corporation
20 Florence Avenue
Batavia, NY 14020

Attention: Chief Accounting Officer

Re: **Notice of Exercise of Non-Qualified Stock Option (Employees)**

Dear Sirs:

This shall constitute my irrevocable direction and authorization to exercise options with respect to shares of Graham Corporation stock previously granted to me under the 2000 Graham Corporation Incentive Plan to Increase Shareholder Value (“Plan”) at \$_____ per share. I further authorize you to issue my shares in my name and deliver them to (“Broker”) for my account.

By copy of this letter, I authorize to the Broker to issue a check from my account maintained with the Broker payable to Graham Corporation in the amount of \$_____.

I represent that the above shares are not subject to any encumbrance or other claim and that you, the Broker, and Graham Corporation’s transfer agent (“Transfer Agent”) may rely upon this exercise notice as a representation and authorization for this purpose.

By copy of this letter, I further authorize the Broker to:

- Exercise and Sell
 - Exercise and Hold
-

You are hereby directed and instructed to issue _____ shares of common stock in my name for my account maintained with the Broker. Please:

- (a) Arrange for electronic transfer of the shares on this date via the Depository Trust to the Broker, whose DTC Number is _____; **or**
- (b) Expedite the overnight delivery of said certificate by express mail to:

Broker Name _____

Address _____

I understand that the difference between the Fair Market Value of the Shares to be issued to me pursuant to this Notice and the Exercise Price of such Shares will be taxable income to me, and that I must consult with my own tax advisor regarding when such income will be reportable. I understand that, under the Plan and Agreement, I am responsible for the amount of any federal, state and local taxes that are required to be paid with respect to the Shares to be issued pursuant to this Notice.

I have been advised by my legal counsel that my acquisition of shares pursuant to this notice and my sale of the shares so acquired is not a transaction to which Section 16(b) of the Securities Exchange Act of 1934 ("short swing profit rule") applies. I acknowledge that under the short swing profit rule I may be liable to the Corporation in the event of a sale occasioned by a margin deficiency in my account.

I understand that I must rely on, and consult with, my own legal counsel (and not the Company) regarding the application of all laws — particularly tax and securities laws — to the transactions to be effected pursuant to this Notice.

Date _____

[Name]

Address



ON BEHALF OF THE COMMITTEE

Received [check one]:

By Hand

By Mail Post Marked

Date of Post Mark

By

Authorized Signature

Date of Receipt

FORM OF
RESTRICTED STOCK AGREEMENT
 (Employee — Under Annual Award Plan)

This RESTRICTED STOCK AGREEMENT (this "Agreement") is made and entered into as of the _____ day of _____, _____, by and between Graham Corporation, a corporation organized and existing under the laws of the State of Delaware and having an office at 20 Florence Avenue, Batavia, New York 14020 (the "Company") and _____ (the "RSA Holder").

WITNESSETH:

WHEREAS, by action of its Board of Directors (the "Board"), the Company has adopted the 2000 Graham Corporation Incentive Plan to Increase Shareholder Value (the "Plan"), pursuant to which Restricted Stock Awards ("RSAs") with respect to shares of common stock of the Company ("Shares") may be granted to the Company's eligible officers and employees; and

WHEREAS, pursuant to Article III of the Plan, a Compensation Committee (the "Committee") has been appointed to select the individuals to whom RSAs shall be granted and to prescribe the terms and conditions of such grants; and

WHEREAS, the Committee has determined that the RSA Holder is eligible to be granted an RSA and desires to grant an RSA to the RSA Holder, and the RSA Holder desires to accept such grant, on the terms and conditions hereinafter set forth;

NOW, THEREFORE, the Company and the RSA Holder hereby agree as follows:

Section 1. Grant of RSA. As of the date set forth above, the Company hereby grants, and the RSA Holder hereby accepts the Company's grant of, an RSA of _____ Shares (the "Restricted Shares"), on the terms and conditions hereinafter set forth.

Section 2. Restrictions and Vesting.

(a) Subject to the terms set forth in this Agreement, provided that the RSA Holder is still a full-time employee of the Company at that time, the Restricted Shares will vest on the following dates (each, a "Vesting Date") as follows:

[vesting schedule]

(b) (i) Upon the date that the RSA Holder becomes eligible for Retirement, a portion of the outstanding Restricted Shares under this Agreement shall immediately vest in full. Such portion shall be the number of shares with a Fair Market Value on such date equal to the minimum tax required to be withheld by the Company on the Fair Market Value of all of the outstanding Restricted Shares under this Agreement on such date. The Company shall deduct and apply the shares that so vest to cover the tax withholding on the Fair Market Value of all outstanding Restricted Shares under this Agreement on such date that are taxable as a result of the employee becoming eligible for Retirement. For purposes of this Agreement, "Retirement" shall mean a voluntary separation from service by the RSA Holder when he or she is at least age 60 and has been employed by the Company on a full-time basis for ten or more years.

(ii) Upon the death, Disability or Retirement of the RSA Holder, all outstanding Restricted Shares under this Agreement shall immediately vest in full.

(c) Except as otherwise provided by Section 2(b), or unless the Committee determines otherwise, if the RSA Holder's employment terminates before a Vesting Date for any reason, the unvested Restricted Shares as of such date shall be forfeited and cancelled immediately.

Section 3. Rights as a Stockholder. The RSA Holder will have the rights of a stockholder with respect to the Restricted Shares, including, but not limited to, the right to receive such cash dividends, if any, as may be declared on such Shares from time to time and the right to vote (in person or by proxy) such Restricted Shares at any meeting of stockholders of the Company.

Section 4. Restrictions on Transfer of Restricted Shares. The Restricted Shares, and the right to vote the Restricted Shares and to receive dividends thereon, may not, except as otherwise provided in the Plan, be sold, assigned, transferred, pledged or encumbered in any way prior to the applicable Vesting Date, whether by operation of law or otherwise, except by will or the laws of descent and distribution. The RSA Holder agrees that any certificate representing the Restricted Shares (or any portion thereof) will be held by the Company's stock transfer agent or other representative of the Company (the "RSA Agent") until the applicable Vesting Dates are satisfied and the Company's provides written authorization to such RSA Agent.

Section 5. Registration and Delivery of Restricted Shares. The Company's obligation to deliver Shares under this Agreement and/or authorize the RSA Agent to release Restricted Shares shall, if the Committee so requests, be conditioned upon the receipt of a representation as to the investment intention of the RSA Holder to whom such Shares are to be delivered, in such form as the Committee shall determine to be reasonably necessary or advisable to comply with the provisions of applicable federal, state or local law. It may be provided that any such representation shall become inoperative upon a registration of the Shares or upon the occurrence of any other event eliminating the necessity of such representation. The Company shall not be required to deliver any Shares under this Agreement prior to (a) the admission of such Shares to listing on any stock exchange on which Shares may then be listed, or (b) the completion of such registration or other qualification under any state or federal law, rule or regulations as the Committee shall determine to be necessary or advisable.

Section 6. Adjustments in the Event of Reorganization. In the event of any merger, consolidation, or other business reorganization in which the Company is the surviving entity, and in the event of any stock split, stock dividend or other event generally affecting the number of Shares held by each person who is then a shareholder of record, the number of Restricted Shares shall be adjusted to account for such event. Such adjustment shall be effected by multiplying such number of Restricted Shares by an amount equal to the number of Shares that would be owned after such event by a person who, immediately prior to such event, was the holder of record of one Share.

Section 7. No Right to Continued Employment. Nothing in this Agreement nor any action of the Board or Committee with respect to this Agreement shall be held or construed to confer upon the RSA Holder any right to a continuation of employment by the Company or any of its affiliates which employ the RSA Holder. The RSA Holder may be dismissed or otherwise dealt with as though this Agreement had not been entered into.

Section 8. Taxes. Where any person is entitled to receive Shares pursuant to the RSA granted hereunder, the Employer shall have the right to require such person to pay to the Employer the amount of any tax which the Employer is required to withhold with respect to such Shares, or, in

lieu thereof, to retain, or to sell without notice, a sufficient number of Shares to cover the amount required to be withheld.

Section 9. No Assignment. The RSA granted hereunder shall not be subject in any manner to anticipation, alienation or assignment, nor shall such RSA be liable for or subject to debts, contracts, liabilities, engagements or torts, nor shall it be transferable by the RSA Holder other than by will or by the laws of descent and distribution.

Section 10. Notices. Any communication required or permitted to be given under the Plan, including any notice, direction, designation, comment, instruction, objection or waiver, shall be in writing and shall be deemed to have been given at such time as it is delivered personally or five (5) days after mailing if mailed, postage prepaid, by registered or certified mail, return receipt requested, addressed to such party at the address listed below, or at such other address as one such party may by written notice specify to the other party:

(a) If to the Committee:

Graham Corporation
20 Florence Avenue
Batavia, New York 14020
Attention: Chief Accounting Officer

(b) If to the RSA Holder, to the RSA Holder's then current residential address as set forth in the Company's personnel records.

Section 11. Successors and Assigns. This Agreement shall inure to the benefit of and shall be binding upon the Company and the RSA Holder and their respective heirs, successors and assigns.

Section 12. Construction of Language. Whenever appropriate in the Agreement, words used in the singular may be read in the plural, words used in the plural may be read in the singular, and words importing the masculine gender may be read as referring equally to the feminine or the neuter. Any reference to a section shall be a reference to a section of this Agreement, unless the context clearly indicates otherwise. Capitalized terms not specifically defined herein shall have the meanings assigned to them under the Plan.

Section 13. Governing Law. This Agreement shall be construed, administered and enforced according to the laws of the State of New York without giving effect to the conflict of laws principles thereof, except to the extent that such laws are preempted by the federal law.

Section 14. Amendment. This Agreement may be amended, in whole or in part and in any manner not inconsistent with the provisions of the Plan, at any time and from time to time by written agreement between the Company and the RSA Holder.

Section 15. Plan Provisions Control. This Agreement and the rights and obligations created hereunder shall be subject to all of the terms and conditions of the Plan. In the event of any conflict between the provisions of the Plan and the provisions of this Agreement, the terms of the Plan, which are incorporated herein by reference, shall control. By signing this Agreement, the RSA Holder acknowledges receipt of a copy of the Plan.

Section 16. Acceptance by RSA Holder. By executing this Agreement and returning a fully executed copy hereof to the Committee at the address specified in section 10, the RSA Holder

signifies his acceptance of the terms and conditions of this RSA. If a fully executed copy of this Agreement is not received by the Committee within forty-five (45) days after the date when it is presented to the RSA Holder, the Committee may revoke the RSA granted, and thereby avoid all obligations, hereunder.

IN WITNESS WHEREOF, the RSA Holder has executed, and the Company has caused its duly authorized representative to execute, this Agreement as of the date first above written.

GRAHAM CORPORATION

By: _____
James R. Lines
President and Chief Executive Officer

ATTEST:

Assistant Secretary

[SEAL]

RSA HOLDER

Name:

CERTIFICATION OF
PRINCIPAL EXECUTIVE OFFICER

I, James R. Lines, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Graham Corporation;
 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
 4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
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5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2008

/s/ James R. Lines

James R. Lines

President and Chief Executive Officer

CERTIFICATION OF
PRINCIPAL FINANCIAL OFFICER

I, Jennifer R. Condame, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Graham Corporation;
 2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
 3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
 4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures, and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
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5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors (or persons performing the equivalent functions):
- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 5, 2008

/s/ Jennifer R. Condame

Jennifer R. Condame

Controller and Chief Accounting Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Graham Corporation (the "Company") on Form 10-Q for the period ending September 30, 2008 as filed with the Securities and Exchange Commission (the "Report"), each of the undersigned certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ James R. Lines
James R. Lines
President and Chief Executive Officer
(Principal Executive Officer)
Date: November 5, 2008

/s/ Jennifer R. Condame
Jennifer R. Condame
Controller and Chief Accounting Officer
(Principal Accounting Officer)
Date: November 5, 2008

A signed original of this written statement required by Section 906 has been provided to Graham Corporation and will be retained by Graham Corporation and furnished to the Securities and Exchange Commission or its staff upon request.