# 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 December 31, 2018**

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

**For the transition period from _____________ to ___________**

**Commission File Number 1-8462**

# GRAHAM CORPORATION
**(Exact name of registrant as specified in its charter)**

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

**585-343-2216**
**(Registrant's telephone number, including area code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer | ☐ | Accelerated filer | ☒ |
| Non-accelerated filer | ☐ | Smaller reporting company | ☐ |
| | | Emerging growth company | ☐ |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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 January 30, 2019, there were outstanding 9,834,082 shares of the registrant's common stock, par value $.10 per share.

Graham Corporation and Subsidiaries

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As of December 31, 2018 and March 31, 2018 and for the Three and Nine-Month Periods Ended December 31, 2018 and 2017


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GRAHAM CORPORATION AND SUBSIDIARIES

FORM 10-Q

DECEMBER 31, 2018

PART I – FINANCIAL INFORMATION

**Item 1. Unaudited Condensed Consolidated Financial Statements**

**GRAHAM CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS**

(Unaudited)

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Amounts in thousands, except per share data) | | (Amounts in thousands, except per share data) | |
| Net sales | $ 17,198 | $ 17,281 | $ 68,190 | $ 55,356 |
| Cost of products sold | 13,456 | 13,785 | 51,079 | 43,341 |
| Gross profit | 3,742 | 3,496 | 17,111 | 12,015 |
| Other expenses and income: | | | | |
| Selling, general and administrative | 4,249 | 4,037 | 13,518 | 11,362 |
| Selling, general and administrative – amortization | 59 | 59 | 178 | 177 |
| Impairment of goodwill and intangible assets | — | 14,816 | — | 14,816 |
| Restructuring charge | — | — | — | 316 |
| Other income | (206) | (119) | (618) | (358) |
| Interest income | (404) | (142) | (1,044) | (455) |
| Interest expense | 5 | 3 | 8 | 8 |
| Total other expenses and income | 3,703 | 18,654 | 12,042 | 25,866 |
| Income (loss) before provision (benefit) for income taxes | 39 | (15,158) | 5,069 | (13,851) |
| (Benefit) provision for income taxes | (56) | (3,536) | 824 | (3,174) |
| Net income (loss) | 95 | (11,622) | 4,245 | (10,677) |
| Retained earnings at beginning of period | 100,271 | 109,731 | 99,011 | 110,544 |
| Cumulative effect of change in accounting principle, net of income tax benefit of $301 | — | — | (1,022) | — |
| Dividends | (983) | (880) | (2,851) | (2,638) |
| Retained earnings at end of period | $ 99,383 | $ 97,229 | $ 99,383 | $ 97,229 |
| Per share data | | | | |
| Basic: | | | | |
| Net income (loss) | $ 0.01 | $ (1.19) | $ 0.43 | $ (1.09) |
| Diluted: | | | | |
| Net income (loss) | $ 0.01 | $ (1.19) | $ 0.43 | $ (1.09) |
| Weighted average common shares outstanding: | | | | |
| Basic | 9,832 | 9,768 | 9,817 | 9,762 |
| Diluted | 9,845 | 9,768 | 9,832 | 9,762 |
| Dividends declared per share | $ 0.10 | $ 0.09 | $ 0.29 | $ 0.27 |

See Notes to Condensed Consolidated Financial Statements.

**GRAHAM CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(Unaudited)

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| | (Amounts in thousands) | | (Amounts in thousands) | |
| Net income (loss) | $ 95 | $ (11,622) | $ 4,245 | $ (10,677) |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustment | 10 | 76 | (323) | 216 |
| Defined benefit pension and other postretirement plans net of income tax expense (benefit) of $48 and $(17), for the three months ended December 31, 2018 and 2017, respectively, and $145 and $169 for the nine months ended December 31, 2018 and 2017, respectively | 170 | 279 | 510 | 619 |
| Total other comprehensive income | 180 | 355 | 187 | 835 |
| Total comprehensive income (loss) | $ 275 | $ (11,267) | $ 4,432 | $ (9,842) |

See Notes to Condensed Consolidated Financial Statements.

## GRAHAM CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

| | December 31, 2018 | March 31, 2018 |
|---|---|---|
| | (Amounts in thousands, except per share data) | |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 16,675 | $ 40,456 |
| Investments | 63,732 | 36,023 |
| Trade accounts receivable, net of allowances ($389 and $339 at December 31 and March 31, 2018, respectively) | 15,157 | 17,026 |
| Unbilled revenue | 7,317 | 8,079 |
| Inventories | 22,525 | 11,566 |
| Prepaid expenses and other current assets | 1,671 | 772 |
| Income taxes receivable | 708 | 1,478 |
| Total current assets | 127,785 | 115,400 |
| Property, plant and equipment, net | 17,365 | 17,052 |
| Prepaid pension asset | 5,262 | 4,369 |
| Goodwill | 1,222 | 1,222 |
| Permits | 1,700 | 1,700 |
| Other intangible assets, net | 3,253 | 3,388 |
| Other assets | 174 | 202 |
| Total assets | $ 156,761 | $ 143,333 |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Current portion of capital lease obligations | $ 52 | $ 88 |
| Accounts payable | 7,477 | 16,151 |
| Accrued compensation | 5,186 | 4,958 |
| Accrued expenses and other current liabilities | 3,822 | 2,885 |
| Customer deposits | 32,572 | 13,213 |
| Total current liabilities | 49,109 | 37,295 |
| Capital lease obligations | 109 | 55 |
| Deferred income tax liability | 1,437 | 1,427 |
| Accrued pension liability | 638 | 565 |
| Accrued postretirement benefits | 659 | 642 |
| Total liabilities | 51,952 | 39,984 |
| Commitments and contingencies (Note 11) | | |
| Stockholders' equity: | | |
| Preferred stock, $1.00 par value, 500 shares authorized | | |
| Common stock, $.10 par value, 25,500 shares authorized, 10,641 and 10,579 shares issued and 9,832 and 9,772 shares outstanding at December 31 and March 31, 2018, respectively | 1,064 | 1,058 |
| Capital in excess of par value | 24,835 | 23,826 |
| Retained earnings | 99,383 | 99,011 |
| Accumulated other comprehensive loss | (8,063 ) | (8,250 ) |
| Treasury stock (809 and 807 shares at December 31 and March 31, 2018, respectively) | (12,410 ) | (12,296 ) |
| Total stockholders' equity | 104,809 | 103,349 |
| Total liabilities and stockholders' equity | $ 156,761 | $ 143,333 |

See Notes to Condensed Consolidated Financial Statements.

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

| | Nine Months Ended December 31, 2018 | Nine Months Ended December 31, 2017 |
|---|---|---|
| Operating activities: | (Dollar amounts in thousands) | |
| Net income (loss) | $ 4,245 | $ (10,677) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation | 1,469 | 1,490 |
| Amortization | 178 | 177 |
| Amortization of unrecognized prior service cost and actuarial losses | 655 | 788 |
| Impairment of goodwill and intangible assets | — | 14,816 |
| Stock-based compensation expense | 797 | 362 |
| Loss on disposal or sale of property, plant and equipment | 30 | 1 |
| Deferred income taxes | 128 | (3,498) |
| (Increase) decrease in operating assets: | | |
| Accounts receivable | 3,050 | (5,029) |
| Unbilled revenue | (2,011) | 5,170 |
| Inventories | 1,813 | 352 |
| Prepaid expenses and other current and non-current assets | (773) | (591) |
| Income taxes receivable | 770 | (1,605) |
| Prepaid pension asset | (893) | (770) |
| Increase (decrease) in operating liabilities: | | |
| Accounts payable | (8,136) | (1,005) |
| Accrued compensation, accrued expenses and other current and non-current liabilities | 946 | (1,593) |
| Customer deposits | 6,177 | 5,400 |
| Long-term portion of accrued compensation, accrued pension liability and accrued postretirement benefits | 90 | 86 |
| Net cash provided by operating activities | 8,535 | 3,874 |
| Investing activities: | | |
| Purchase of property, plant and equipment | (1,471) | (543) |
| Proceeds from disposal of property, plant and equipment | — | 1 |
| Purchase of investments | (101,343) | (34,023) |
| Redemption of investments at maturity | 73,633 | 30,000 |
| Net cash used by investing activities | (29,181) | (4,565) |
| Financing activities: | | |
| Principal repayments on capital lease obligations | (81) | (78) |
| Issuance of common stock | 171 | — |
| Dividends paid | (2,851) | (2,638) |
| Purchase of treasury stock | (146) | (119) |
| Net cash used by financing activities | (2,907) | (2,835) |
| Effect of exchange rate changes on cash | (228) | 211 |
| Net decrease in cash and cash equivalents | (23,781) | (3,315) |
| Cash and cash equivalents at beginning of year | 40,456 | 39,474 |
| Cash and cash equivalents at end of period | $ 16,675 | $ 36,159 |

See Notes to Condensed Consolidated Financial Statements.

**GRAHAM CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

**NINE MONTHS ENDED DECEMBER 31, 2018**
(Dollar and share amounts in thousands)
(Unaudited)

| | Common Stock | | Capital in | | Accumulated Other | | Total |
|---|---|---|---|---|---|---|---|
| | Shares | Par Value | Excess of Par Value | Retained Earnings | Comprehensive Loss | Treasury Stock | Stockholders' Equity |
| Balance at April 1, 2018 | 10,579 | $ 1,058 | $ 23,826 | $ 99,011 | $ (8,250) | $ (12,296) | $ 103,349 |
| Cumulative effect of change in accounting principle | | | | (1,022) | | | (1,022) |
| Comprehensive income | | | | 2,323 | (29) | | 2,294 |
| Issuance of shares | 59 | 6 | 96 | | | | 102 |
| Dividends | | | | (885) | | | (885) |
| Recognition of equity-based compensation expense | | | 260 | | | | 260 |
| Purchase of treasury stock | | | | | | (146) | (146) |
| Balance at June 30, 2018 | 10,638 | 1,064 | 24,182 | 99,427 | (8,279) | (12,442) | 103,952 |
| Comprehensive income | | | | 1,827 | 36 | | 1,863 |
| Issuance of shares | 4 | | 69 | | | | 69 |
| Dividends | | | | (983) | | | (983) |
| Recognition of equity-based compensation expense | | | 274 | | | | 274 |
| Issuance of treasury stock | | | 47 | | | 32 | 79 |
| Balance at September 30, 2018 | 10,642 | 1,064 | 24,572 | 100,271 | (8,243) | (12,410) | 105,254 |
| Comprehensive income | | | | 95 | 180 | | 275 |
| Forfeiture of shares | (1) | | | | | | — |
| Dividends | | | | (983) | | | (983) |
| Recognition of equity-based compensation expense | | | 263 | | | | 263 |
| Balance at December 31, 2018 | 10,641 | $ 1,064 | $ 24,835 | $ 99,383 | $ (8,063) | $ (12,410) | $ 104,809 |

See Notes to Condensed Consolidated Financial Statements.

**GRAHAM CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

**NINE MONTHS ENDED DECEMBER 31, 2017**
(Dollar and share amounts in thousands)
(Unaudited)

| | Common Stock | | Capital in Excess of Par Value | Retained Earnings | Accumulated Other Comprehensive Loss | Treasury Stock | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | Shares | Par Value | | | | | |
| Balance at April 1, 2017 | 10,548 | $ 1,055 | $ 23,176 | $ 110,544 | $ (8,434) | $ (12,231) | $ 114,110 |
| Comprehensive income | | | | 935 | 224 | | 1,159 |
| Issuance of shares | 32 | 3 | (3) | | | | — |
| Dividends | | | | (879) | | | (879) |
| Recognition of equity-based compensation expense | | | (67) | | | | (67) |
| Purchase of treasury stock | | | | | | (119) | (119) |
| Balance at June 30, 2017 | 10,580 | 1,058 | 23,106 | 110,600 | (8,210) | (12,350) | 114,204 |
| Comprehensive income | | | | 10 | 256 | | 266 |
| Dividends | | | | (879) | | | (879) |
| Recognition of equity-based compensation expense | | | 216 | | | | 216 |
| Issuance of treasury stock | | | 38 | | | 24 | 62 |
| Balance at September 30, 2017 | 10,580 | 1,058 | 23,360 | 109,731 | (7,954) | (12,326) | 113,869 |
| Comprehensive income | | | | (11,622) | 355 | | (11,267) |
| Forfeiture of shares | (1) | | | | | | — |
| Dividends | | | | (880) | | | (880) |
| Recognition of equity-based compensation expense | | | 213 | | | | 213 |
| Balance at December 31, 2017 | 10,579 | $ 1,058 | $ 23,573 | $ 97,229 | $ (7,599) | $ (12,326) | $ 101,935 |

See Notes to Condensed Consolidated Financial Statements.

**NOTE 1 – BASIS OF PRESENTATION:**

Graham Corporation's (the "Company's") Condensed Consolidated Financial Statements include its (i) wholly-owned foreign subsidiary located in Suzhou, China and (ii) wholly-owned domestic subsidiary located in Lapeer, Michigan. The Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the U.S. ("GAAP") for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, each as promulgated by the Securities and Exchange Commission. The Company's Condensed Consolidated Financial Statements do not include all information and notes required by GAAP for complete financial statements. The unaudited Condensed Consolidated Balance Sheet as of March 31, 2018 presented herein was derived from the Company's audited Consolidated Balance Sheet as of March 31, 2018. For additional information, please refer to the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2018 ("fiscal 2018"). 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 nine months ended December 31, 2018 are not necessarily indicative of the results that may be expected for the current fiscal year, which ends March 31, 2019 ("fiscal 2019").

Certain reclassifications have been made to prior year amounts to conform to the current year presentation. See Note 15 which discusses the Company's application of the amended guidance related to the classification of pension and other postretirement benefit costs.

In the third quarter of fiscal 2019, the Company established Graham India Private Limited ("GIPL") as a wholly-owned subsidiary. GIPL, located in Ahmedabad, India, will serve as a sales and market development office focusing on the refining, petrochemical and fertilizer markets.

**NOTE 2 – REVENUE RECOGNITION:**

The Company accounts for revenue in accordance with Accounting Standard Codification 606, "Revenue from Contracts with Customers" ("ASC 606"), which it adopted on April 1, 2018 using the modified retrospective approach. See Note 15 to the Condensed Consolidated Financial Statements for further discussion of this adoption.

The Company recognizes revenue on all contracts when control of the product is transferred to the customer. Control is generally transferred when products are shipped, title is transferred, significant risks of ownership have transferred, the Company has rights to payment, and rewards of ownership pass to the customer.

The following table presents the Company's revenue disaggregated by product line and geographic area:

| Product Line | Three Months Ended December 31, 2018 | Three Months Ended December 31, 2017 | Nine Months Ended December 31, 2018 | Nine Months Ended December 31, 2017 |
|---|---|---|---|---|
| Heat transfer equipment | $ 5,164 | $ 7,608 | $ 15,495 | $ 18,591 |
| Vacuum equipment | 3,765 | 3,858 | 28,823 | 15,270 |
| All other | 8,269 | 5,815 | 23,872 | 21,495 |
| Net sales | $ 17,198 | $ 17,281 | $ 68,190 | $ 55,356 |

| Geographic Region | Three Months Ended December 31, 2018 | Three Months Ended December 31, 2017 | Nine Months Ended December 31, 2018 | Nine Months Ended December 31, 2017 |
|---|---|---|---|---|
| Asia | $ 966 | $ 2,264 | $ 5,591 | $ 8,228 |
| Canada | 549 | 1,847 | 15,672 | 5,046 |
| Middle East | 806 | 1,023 | 1,705 | 2,958 |
| South America | 47 | 485 | 239 | 1,055 |
| U.S. | 14,320 | 11,301 | 42,846 | 37,276 |
| All other | 510 | 361 | 2,137 | 793 |
| Net sales | $ 17,198 | $ 17,281 | $ 68,190 | $ 55,356 |

A performance obligation represents a promise in a contract to provide a distinct good or service to a customer and is the unit of accounting pursuant to ASC 606. The Company accounts for a contract when it has approval and commitment from both parties, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable. Transaction price reflects the amount of consideration to which the Company expects to be entitled in exchange for transferred products. A contract's transaction price is allocated to each distinct performance obligation and revenue is recognized as the performance obligation is satisfied. In certain cases, the Company may separate a contract into more than one performance obligation, while in other cases, several products may be part of a fully integrated solution and are bundled into a single performance obligation. If a contract is separated into more than one performance obligation, the Company allocates the total transaction price to each performance obligation in an amount based on the estimated relative standalone selling prices of the promised goods underlying each performance obligation. The Company has made an accounting policy election to exclude from the measurement of the contract price all taxes assessed by government authorities that are collected by the Company from its customers. The Company does not adjust the contract price for the effects of a financing component if the Company expects, at contract inception, that the period between when a product is transferred to a customer and when the customer pays for the product will be one year or less. Shipping and handling fees billed to the customer are recorded in revenue and the related costs incurred for shipping and handling are included in cost of products sold.

Revenue on the majority of the Company's contracts, as measured by number of contracts, is recognized upon shipment to the customer, however, revenue on larger contracts, which are fewer in number but generally represent the majority of revenue, is recognized over time as these contracts meet specific criteria established in ASC 606. Revenue from contracts that is recognized upon shipment accounted for approximately 50% and 40% of revenue in the three and nine months ended December 31, 2018, respectively, and revenue from contracts that is recognized over time accounted for approximately 50% and 60% of revenue in the three and nine months ended December 31, 2018. The Company recognizes revenue over time when contract performance results in the creation of a product for which the Company does not have an alternative use and the contract includes an enforceable right to payment in an amount that corresponds directly with the value of the performance completed. To measure progress towards completion on performance obligations for which revenue is recognized over time the Company utilizes an input method based upon a ratio of direct labor hours incurred to date to management's estimate of the total labor hours to be incurred on each contract or an output method based upon completion of operational milestones, depending upon the nature of the contract. The Company has established the systems and procedures essential to developing the estimates required to account for performance obligations over time. These procedures include monthly review by management of costs incurred, progress towards completion, identified risks and opportunities, sourcing determinations, changes in estimates of costs yet to be incurred, availability of materials, and execution by subcontractors. Sales and earnings are adjusted on a cumulative catch-up basis in current accounting periods based upon revisions in the contract value due to pricing changes and estimated costs at completion. Losses on contracts are recognized immediately when evident to management.

The timing of revenue recognition, invoicing and cash collections affect trade accounts receivable, unbilled revenue (contract assets) and customer deposits (contract liabilities) on the Consolidated Balance Sheets. Unbilled revenue represents revenue on contracts that is recognized over time and exceeds the amount that has been billed to the customer. Unbilled revenue is separately presented in the Consolidated Balance Sheets. The Company may receive a customer deposit or have an unconditional right to receive a customer deposit prior to revenue being recognized. Since the performance obligations related to such customer deposits may not have been satisfied, a contract liability is recorded and an offsetting asset of equal amount is recorded as a trade accounts receivable

until the deposit is collected. Customer deposits are separately presented in the Consolidated Balance Sheets. Customer deposits are not considered a significant financing component as they are generally received less than one year before the product is completed or used to procure specific material on a contract, as well as related overhead costs incurred during design and construction.

Net contract assets (liabilities) consisted of the following:

| | December 31, 2018 | April 1, 2018 | Change |
|---|---|---|---|
| Unbilled revenue (contract assets) | $ 7,317 | $ 6,092 | $ 1,225 |
| Customer deposits (contract liabilities) | (32,572 ) | (26,585 ) | (5,987 ) |
| Net contract liabilities | $ (25,255 ) | $ (20,493 ) | $ (4,762 ) |

Contract liabilities at December 31, 2018 and April 1, 2018 include $4,453 and $2,220, respectively, of customer deposits for which the Company has an unconditional right to collect payment. Trade accounts receivable, as presented on the Consolidated Balance Sheets and within Note 15, includes corresponding balances at December 31, 2018 and April 1, 2018, respectively. Revenue recognized in the three and nine-month periods ended December 31, 2018 that was included in the contract liability balance at April 1, 2018 was $397 and $9,323, respectively. Changes in the net contract liability balance during the nine-month period ended December 31, 2018 were impacted by a $1,225 increase in contract assets, of which $6,503 was due to contract progress offset by invoicing to customers of $5,278. In addition, contract liabilities decreased $5,987 driven by revenue recognized in the nine-month period that was included in the contract liability balance at April 1, 2018 offset by new customer deposits of $15,310.

Receivables billed but not paid under retainage provisions in the Company's customer contracts were $2,027 and $1,124 at December 31, 2018 and March 31, 2018, respectively.

Incremental costs to obtain a contract consist of sales employee and agent commissions. Commissions paid to employees and sales agents are capitalized when paid and amortized to selling, general and administrative expense when the related revenue is recognized. Capitalized costs, net of amortization, to obtain a contract were $126 and $118 at December 31, 2018 and April 1, 2018, respectively, and are included in the line item "Prepaid expenses and other current assets" in the Condensed Consolidated Balance Sheets. The related amortization expense was $33 and $115 in the three and nine months ended December 31, 2018, respectively.

The Company's remaining unsatisfied performance obligations represent a measure of the total dollar value of work to be performed on contracts awarded and in progress. The Company also refers to this measure as backlog. As of December 31, 2018, the Company had remaining unsatisfied performance obligations of $133,694. The Company expects to recognize revenue on approximately 50% to 55% of the remaining performance obligations within one year, 10% to 20% in one to two years and the remaining beyond two years.

**NOTE 3 – INVESTMENTS:**

Investments consist of certificates of deposits with financial institutions. All investments have original maturities of greater than three months and less than one year and are classified as held-to-maturity, as the Company believes it has the intent and ability to hold the securities to maturity. Investments are stated at amortized cost which approximates fair value. All investments held by the Company at December 31, 2018 are scheduled to mature on or before September 25, 2019.

**NOTE 4 – INVENTORIES:**

Inventories are stated at the lower of cost or net realizable value, using the average cost method. Unbilled revenue (contract assets) in the Condensed Consolidated Balance Sheets represents revenue recognized that has not been billed to customers on contracts in which revenue is recognized over time. Upon adoption of the new revenue recognition guidance discussed in Note 15, all progress payments exceeding unbilled revenue are presented as customer deposits (contract liabilities) in the Condensed Consolidated Balance Sheets. Under the previous guidance, progress payments exceeding unbilled revenue were netted against inventory to the extent the payment was less than or equal to the inventory balance relating to the applicable contract, and the excess was presented as customer deposits in the Condensed Consolidated Balance Sheets.

Major classifications of inventories are as follows:

| | December 31, 2018 | March 31, 2018 |
|---|---|---|
| Raw materials and supplies | $ 2,747 | $ 3,095 |
| Work in process | 16,254 | 17,546 |
| Finished products | 3,524 | 1,034 |
| | 22,525 | 21,675 |
| Less - progress payments | — | 10,109 |
| Total | $ 22,525 | $ 11,566 |

**NOTE 5 – INTANGIBLE ASSETS:**

Intangible assets are comprised of the following:

| | Gross Carrying Amount | Accumulated Amortization | Impairment Loss | Net Carrying Amount |
|---|---|---|---|---|
| At December 31, 2018 | | | | |
| Intangibles subject to amortization: | | | | |
| Customer relationships | $ 2,700 | $ 1,447 | $ — | $ 1,253 |
| Intangibles not subject to amortization: | | | | |
| Permits | $ 10,300 | $ — | $ 8,600 | $ 1,700 |
| Tradename | 2,500 | — | 500 | 2,000 |
| | $ 12,800 | $ — | $ 9,100 | $ 3,700 |
| At March 31, 2018 | | | | |
| Intangibles subject to amortization: | | | | |
| Customer relationships | $ 2,700 | $ 1,312 | $ — | $ 1,388 |
| Intangibles not subject to amortization: | | | | |
| Permits | $ 10,300 | $ — | $ 8,600 | $ 1,700 |
| Tradename | 2,500 | — | 500 | 2,000 |
| | $ 12,800 | $ — | $ 9,100 | $ 3,700 |

Intangible assets are amortized on a straight-line basis over the estimated useful lives. Intangible amortization expense for each of the three-month periods ended December 31, 2018 and 2017 was $45. Intangible amortization expense for each of the nine-month periods ended December 31, 2018 and 2017 was $135. As of December 31, 2018, amortization expense is estimated to be $45 for the remainder of fiscal 2019 and $180 in each of the fiscal years ending March 31, 2020, 2021, 2022 and 2023.

**NOTE 6 – STOCK-BASED COMPENSATION:**

The Amended and Restated 2000 Graham Corporation Incentive Plan to Increase Shareholder Value, as approved by the Company's stockholders at the Annual Meeting on July 28, 2016, 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 467 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.

No restricted stock awards were granted in the three-month periods ended December 31, 2018 and 2017. Restricted stock awards granted in the nine-month periods ended December 31, 2018 and 2017 were 53 and 59, respectively. Restricted shares of 27 and 30 granted to officers in the first nine months of fiscal 2019 and fiscal 2018, respectively, vest 100% on the third anniversary of the grant date subject to the satisfaction of the performance metrics for the applicable three-year period. Restricted shares of 20 and 22 granted to officers and key employees in the first nine months of fiscal 2019 and fiscal 2018, respectively, vest 33⅓% per year over a three-year term. Restricted shares of 6 and 7 granted to directors in the first nine months of fiscal 2019 and fiscal 2018, respectively, vest 100% on the first year anniversary of the grant date. No stock option awards were granted in the three-month or nine-month periods ended December 31, 2018 and 2017.

During the three months ended December 31, 2018 and 2017, the Company recognized stock-based compensation costs related to stock option and restricted stock awards of $263 and $213, respectively. The income tax benefit recognized related to stock-based

compensation was $59 and $24 for the three months ended December 31, 2018 and 2017, respectively. During the nine months ended December 31, 2018 and 2017, the Company recognized stock-based compensation costs related to stock option and restricted stock awards of $797 and $362, respectively. The income tax benefit recognized related to stock-based compensation was $177 and $77 for the nine months ended December 31, 2018 and 2017, respectively.

The Company has an Employee Stock Purchase Plan (the "ESPP"), which allows eligible employees to purchase shares of the Company's common stock at a discount of up to 15% of its fair market value on the (i) last, (ii) first or (iii) lower of the last or first day of the six-month Offering Period, as defined in the ESPP. A total of 200 shares of common stock may be purchased under the ESPP. During each of the three months and nine months ended December 31, 2018 and 2017, no stock-based compensation costs were recognized related to the ESPP.

**NOTE 7 – INCOME PER SHARE:**

Basic income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. 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 December 31, | | Nine Months Ended December 31, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Basic income (loss) per share | | | | |
| Numerator: | | | | |
| Net income (loss) | $ 95 | $ (11,622) | $ 4,245 | $ (10,677) |
| Denominator: | | | | |
| Weighted average common shares outstanding | 9,832 | 9,768 | 9,817 | 9,762 |
| Basic income (loss) per share | $ .01 | $ (1.19) | $ .43 | $ (1.09) |
| Diluted income (loss) per share | | | | |
| Numerator: | | | | |
| Net income (loss) | $ 95 | $ (11,622) | $ 4,245 | $ (10,677) |
| Denominator: | | | | |
| Weighted average common shares outstanding | 9,832 | 9,768 | 9,817 | 9,762 |
| Stock options outstanding | 13 | — | 15 | — |
| Weighted average common and potential common shares outstanding | 9,845 | 9,768 | 9,832 | 9,762 |
| Diluted income (loss) per share | $ .01 | $ (1.19) | $ .43 | $ (1.09) |

None of the options to purchase shares of common stock which totaled 69 were included in the computation of diluted loss per share for the three and nine months ended December 31, 2017 as the effect would be anti-dilutive due to the net loss in the periods.

**NOTE 8 – PRODUCT WARRANTY LIABILITY:**

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

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Balance at beginning of period | $ 349 | $ 301 | $ 493 | $ 538 |
| Expense (income) for product warranties | 76 | 22 | 87 | (59) |
| Product warranty claims paid | (15) | (22) | (170) | (178) |
| Balance at end of period | $ 410 | $ 301 | $ 410 | $ 301 |

Income of $59 in the nine months ended December 31, 2017 resulted from the reversal of provisions made that were no longer required due to lower claims experience.

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

**NOTE 9 - CASH FLOW STATEMENT:**

Interest paid was $8 in each of the nine-month periods ended December 31, 2018 and 2017. Income taxes paid (refunded) for the nine months ended December 31, 2018 and 2017 were $(74) and $1,801, respectively.

In the nine months ended December 31, 2018 and 2017, non-cash activities included the issuance of treasury stock valued at $79 and $62, respectively, to the Company's ESPP.

At December 31, 2018 and 2017, there were $242 and $29, respectively, of capital purchases that were recorded in accounts payable and are not included in the caption "Purchase of property, plant and equipment" in the Condensed Consolidated Statements of Cash Flows.

In the nine months ended December 31, 2018 and 2017, capital expenditures totaling $100 and $0, respectively, were financed through the issuance of capital leases.

**NOTE 10 – EMPLOYEE BENEFIT PLANS:**

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

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Service cost | $ 142 | $ 149 | $ 428 | $ 448 |
| Interest cost | 335 | 356 | 1,005 | 1,067 |
| Expected return on assets | (766) | (743) | (2,297) | (2,232) |
| Amortization of actuarial loss | 212 | 253 | 635 | 760 |
| Net pension (income) cost | $ (77) | $ 15 | $ (229) | $ 43 |

The Company made contributions to its defined benefit pension plan of $30 during the nine months ended December 31, 2018 and does not expect to make contributions to the plan for the balance of fiscal 2019.

The components of the postretirement benefit cost are as follows:

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Interest cost | $ 7 | $ 6 | $ 19 | $ 19 |
| Amortization of actuarial loss | 6 | 9 | 20 | 28 |
| Net postretirement benefit cost | $ 13 | $ 15 | $ 39 | $ 47 |

The Company paid no benefits related to its postretirement benefit plan during the nine months ended December 31, 2018. The Company expects to pay benefits of approximately $83 for the balance of fiscal 2019.

The Company self-funds the medical insurance coverage it provides to its U.S. based employees. The Company maintains a stop loss insurance policy in order to limit its exposure to claims. The liability of $134 and $122 on December 31, 2018 and March 31, 2018, respectively, related to the self-insured medical plan is primarily based upon claim history and is included in the caption "Accrued compensation" as a current liability in the Condensed Consolidated Balance Sheets.

**NOTE 11 – COMMITMENTS AND CONTINGENCIES:**

The Company has been named as a defendant in lawsuits alleging personal injury from exposure to asbestos allegedly contained in, or accompanying, 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 in the Company's current lawsuits are similar to those made in previous asbestos-related suits that named the Company as defendant, which either were dismissed when it was shown

that the Company had not supplied products to the plaintiffs' places of work or were settled for immaterial amounts. The Company cannot provide any assurances that any pending or future matters will be resolved in the same manner as previous lawsuits.

As of December 31, 2018, the Company was subject to the claims noted above, as well as other legal proceedings and potential claims that have arisen in the ordinary course of business.

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

**NOTE 12 – INCOME TAXES:**

The Company files federal and state income tax returns in several domestic and international jurisdictions. In most tax jurisdictions, returns are subject to examination by the relevant tax authorities for a number of years after the returns have been filed. The Company is subject to U.S. federal examination for the tax years 2015 through 2017 and examination in state tax jurisdictions for the tax years 2013 through 2017. The Company is subject to examination in the People's Republic of China for tax years 2015 through 2017.

There was no liability for unrecognized tax benefits at either December 31, 2018 or March 31, 2018.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was signed into law. The Tax Act significantly revised the U.S. tax code by, among other changes, lowering the corporate income tax rate from 35% to 21%, requiring a one-time transition tax on accumulated foreign earnings of certain foreign subsidiaries that were previously tax deferred and creating new taxes on certain foreign sourced earnings. The Company remeasured certain U.S. deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally 21%, and recorded an income tax benefit of $971 related to such re-measurement in fiscal 2018.

The one-time transition tax is based on the total post-1986 earnings and profits ("E&P") of our foreign subsidiary that has previously been deferred from U.S. income taxes. The Company recorded its one-time transition liability of its foreign subsidiary resulting in additional income tax expense of $185 in fiscal 2018. The transition tax is based in part on the amount of those earnings held in cash and other specified assets.

The Tax Act also includes two new U.S. tax base-erosion provisions, the global intangible low-taxed income ("GILTI") provisions and the base-erosion and anti-abuse tax ("BEAT") provisions, beginning in 2018. The GILTI provisions require the Company to include in its U.S. income tax return foreign subsidiary earnings in excess of an allowable return on its foreign subsidiary's tangible assets. The Company does not expect incremental U.S. tax on GILTI income beginning in 2018 due to the utilization of foreign tax credits. The Company has elected to account for GILTI tax in the period in which it is incurred. The BEAT provisions in the Tax Act eliminate the deduction of certain base-erosion payments made to related foreign corporations and impose a minimum tax if greater than regular tax. The Company does not expect it will be subject to this tax.

The Tax Act also provides tax incentives to U.S. companies to earn income from the sale, lease or license of goods and services abroad in the form of a deduction for foreign-derived intangible income ("FDII"). FDII is taxed at an effective rate of 13.125% for taxable years beginning after December 31, 2017. The Company's incremental U.S. tax savings on FDII beginning in fiscal 2019 is estimated to be approximately $200.

The U.S. Securities and Exchange Commission issued Staff Accounting Bulletin No. 118 to address the application of U.S. GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. The Company recognized the provisional tax impacts related to the revaluation of deferred tax assets and liabilities and included the amount in its consolidated financial statements for fiscal 2018. As of March 31, 2018, the Company had completed the majority of its accounting for the tax effects of the Tax Act. During the three-month and nine-month periods ended December 31, 2018, there were no changes made to the provisional amounts recorded in fiscal 2018.

**NOTE 13 – CHANGES IN ACCUMULATED OTHER COMPREHENSIVE LOSS:**

The changes in accumulated other comprehensive loss by component for the nine months ended December 31, 2018 and 2017 are as follows:

| | Pension and Other Postretirement Benefit Items | Foreign Currency Items | Total |
|---|---|---|---|
| Balance at April 1, 2018 | $ (8,599) | $ 349 | $ (8,250) |
| Other comprehensive income before reclassifications | — | (323) | (323) |
| Amounts reclassified from accumulated other comprehensive loss | 510 | — | 510 |
| Net current-period other comprehensive income | 510 | (323) | 187 |
| Balance at December 31, 2018 | $ (8,089) | $ 26 | $ (8,063) |

| | Pension and Other Postretirement Benefit Items | Foreign Currency Items | Total |
|---|---|---|---|
| Balance at April 1, 2017 | $ (8,439) | $ 5 | $ (8,434) |
| Other comprehensive income before reclassifications | — | 216 | 216 |
| Amounts reclassified from accumulated other comprehensive loss | 619 | — | 619 |
| Net current-period other comprehensive income | 619 | 216 | 835 |
| Balance at December 31, 2017 | $ (7,820) | $ 221 | $ (7,599) |

The reclassifications out of accumulated other comprehensive loss by component for the three and nine months ended December 31, 2018 and 2017 are as follows:

| Details about Accumulated Other Comprehensive Loss Components | Amount Reclassified from Accumulated Other Comprehensive Loss | | Affected Line Item in the Condensed Consolidated Statements of Operations and Retained Earnings |
|---|---|---|---|
| | Three Months Ended December 31, | | |
| | 2018 | 2017 | |
| Pension and other postretirement benefit items: | | | |
| Amortization of actuarial loss | $ (218) [(1)] | $ (262) [(1)] | Income before provision for income taxes |
| | (48) | 17 | Provision for income taxes |
| | $ (170) | $ (279) | Net income |

| Details about Accumulated Other Comprehensive Loss Components | Amount Reclassified from Accumulated Other Comprehensive Loss | | Affected Line Item in the Condensed Consolidated Statements of Operations and Retained Earnings |
|---|---|---|---|
| | Nine Months Ended December 31, | | |
| | 2018 | 2017 | |
| Pension and other postretirement benefit items: | | | |
| Amortization of actuarial loss | $ (655) [(1)] | $ (788) [(1)] | Income before provision for income taxes |
| | (145) | (169) | Provision for income taxes |
| | $ (510) | $ (619) | Net income |

(1) These accumulated other comprehensive loss components are included within the computation of pension and other postretirement benefit costs. See Note 10.

**NOTE 14 – RESTRUCTURING CHARGE:**

In fiscal 2018, the Company aligned its workforce with market conditions by reducing the number of management, office and manufacturing positions. As a result, a restructuring charge of $316 was recognized in the nine months ended December 31, 2017. The restructuring charge included severance and related employee benefit costs. The charge is included in the caption "Restructuring Charge" in the Condensed Consolidated Statements of Operations and Retained Earnings for the nine months ended December 31, 2017. The reconciliation of the changes in the restructuring reserve is as follows:

| | Nine Months Ended December 31, 2018 | Nine Months Ended December 31, 2017 |
|---|---|---|
| Balance at beginning of period | $ 18 | $ 120 |
| Expense for restructuring | — | 316 |
| Amounts paid for restructuring | (18) | (336) |
| Balance at end of period | $ — | $ 100 |

The liability of $18 at March 31, 2018 is included in the caption "Accrued Compensation" in the Condensed Consolidated Balance Sheet.

**NOTE 15 – ACCOUNTING AND REPORTING CHANGES:**

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

In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers." This guidance establishes principles for reporting information about the nature, amount, timing and uncertainty of revenue and cash flows arising from a company's contracts with customers. The guidance requires companies to apply a five-step model when recognizing revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods and services. The guidance also includes a comprehensive set of disclosure requirements regarding revenue recognition. The guidance allows two methods of adoption: (1) a full retrospective approach where historical financial information is presented in accordance with the new standard and (2) a modified retrospective approach where the guidance is applied to the most current period presented in the financial statements. In August 2015, the FASB issued ASU No 2015-14 "Revenue from Contracts with Customers: Deferral of the Effective Date," which deferred the effective date of ASU 2014-09 to annual reporting periods beginning after December 15, 2017, with earlier application permitted as of annual reporting periods beginning after December 15, 2016. In March 2016, the FASB issued ASU No. 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)," to clarify the implementation guidance on principal versus agent. In April 2016, the FASB issued ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," which clarifies the identifying performance obligations and licensing implementation guidance. In May 2016, the FASB issued ASU No. 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients," which clarifies the implementation guidance related to collectability, presentation of sales tax, noncash consideration, contract modifications and completed contracts at transition.

The Company adopted the revenue recognition standard using the modified retrospective approach on April 1, 2018. The Company recognized the cumulative effect of initially applying the new standard to all contracts that were not completed on the date of adoption as an adjustment to the opening balance of retained earnings. The comparative information has not been restated and continues to be reported under the accounting standard in effect during those periods. The most significant impact of adopting the guidance is the timing of revenue recognition. Revenue on the majority of the Company's contracts continues to be recognized upon shipment while revenue on its larger contracts is recognized over time as these contracts meet specific criteria established in the new standards. Consistent with previous guidance, revenue recognized on contracts over time created unbilled revenue (contract assets) and reduced inventory on the Company's Condensed Consolidated Balance Sheets. Upon adoption of the new standard, progress payments for which the Company has received an unconditional right to payment are recognized as trade accounts receivable with a corresponding contract liability of an equal amount as customer deposits on the Company's Condensed Consolidated Balance Sheets since the related performance obligations have not been satisfied. Under the previous guidance, progress payments were recognized when payment was received. In addition, progress payments exceeding unbilled revenue were netted against inventory to the extent the payment was less than or equal to the inventory balance relating to the applicable contract and the excess was presented as customer deposits.

The following table presents the cumulative effect of the changes made to the Company's Consolidated Balance Sheet as of April 1, 2018 for the adoption of the new revenue recognition standard:

| | Balance at March 31, 2018 | Adjustments Due to Adoption of Revenue Recognition Standard | Balance at April 1, 2018 |
|---|---|---|---|
| Assets | | | |
| Trade accounts receivable | $ 17,026 | $ 538 | $ 17,564 |
| Unbilled revenue | 8,079 | (1,987 ) | 6,092 |
| Inventories | 11,566 | 12,985 | 24,551 |
| Prepaid expenses and other current assets | 772 | 118 | 890 |
| Other assets | 202 | 69 | 271 |
| Liabilities | | | |
| Accounts payable | 16,151 | (706 ) | 15,445 |
| Accrued compensation | 4,958 | (172 ) | 4,786 |
| Accrued expenses and other current liabilities | 2,885 | 484 | 3,369 |
| Customer deposits | 13,213 | 13,372 | 26,585 |
| Deferred income tax liability | 1,427 | (233 ) | 1,194 |
| Stockholders' equity: | | | |
| Retained earnings | 99,011 | (1,022 ) | 97,989 |

The following tables present the impact of adoption of the new revenue recognition standard on the Consolidated Statements of Operations and Balance Sheet:

| | Three Months Ended December 31, 2018 | | | Nine Months Ended December 31, 2018 | | |
|---|---|---|---|---|---|---|
| | As Reported | Balances Without Adoption of Revenue Recognition Standard | Effect of Change | As Reported | Balances Without Adoption of Revenue Recognition Standard | Effect of Change |
| Consolidated Statements of Operations | | | | | | |
| Net sales | $ 17,198 | $ 18,278 | $ (1,080 ) | $ 68,190 | $ 67,413 | $ 777 |
| Cost of products sold | 13,456 | 14,406 | (950 ) | 51,079 | 50,182 | 897 |
| Gross profit | 3,742 | 3,872 | (130 ) | 17,111 | 17,231 | (120 ) |
| Selling, general and administrative | 4,249 | 4,264 | (15 ) | 13,518 | 13,548 | (30 ) |
| Income before provision for income taxes | 39 | 154 | (115 ) | 5,069 | 5,159 | (90 ) |
| Provision (benefit) for income taxes | (56 ) | (36 ) | (20 ) | 824 | 839 | (15 ) |
| Net income | 95 | 190 | (95 ) | 4,245 | 4,320 | (75 ) |

| | December 31, 2018 | | |
|---|---|---|---|
| Consolidated Balance Sheet | As Reported | Balances Without Adoption of Revenue Recognition Standard | Effect of Change |
| Assets | | | |
| Trade accounts receivable, net of allowances | $ 15,157 | $ 14,114 | $ 1,043 |
| Unbilled revenue | 7,317 | 8,095 | (778 ) |
| Inventories | 22,525 | 9,379 | 13,146 |
| Prepaid expenses and other current assets | 1,671 | 1,546 | 125 |
| Other assets | 174 | 156 | 18 |
| | | | |
| Liabilities and stockholders' equity | | | |
| Accounts payable | 7,477 | 7,404 | 73 |
| Accrued compensation | 5,186 | 5,355 | (169 ) |
| Accrued expenses and other current liabilities | 3,822 | 3,895 | (73 ) |
| Customer deposits | 32,572 | 17,389 | 15,183 |
| Deferred income tax liability | 1,437 | 1,732 | (295 ) |
| | | | |
| Stockholders' equity | | | |
| Retained earnings | 99,383 | 100,550 | (1,167 ) |
| Accumulated other comprehensive loss | (8,063 ) | (8,065 ) | 2 |

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)," which requires companies to recognize all leases as assets and liabilities on the consolidated balance sheet. This ASU retains a distinction between finance leases and operating leases, and the classification criteria for distinguishing between finance leases and operating leases are substantially similar to the classification criteria for distinguishing between capital leases and operating leases in the current accounting guidance. As a result, the effect of leases on the consolidated statement of comprehensive income and the consolidated statement of cash flows is largely unchanged from previous generally accepted accounting principles. The guidance requires application on a modified retrospective basis based on the earliest period presented in the consolidated financial statements. In July 2018, the FASB issued ASU No. 2018-11, "Leases (Topic 842) Targeted Improvements," which provides an additional transition method that allows entities to initially apply the guidance at the adoption date and recognize a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption. In addition, the guidance provides a practical expedient that allows entities to account for lease components and associated nonlease components as a single component if specific conditions are met. The amendments in these ASUs are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Earlier application is permitted. The Company believes the adoption of this ASU may have a material impact on its assets and liabilities due to the addition of right-of-use assets and lease liabilities to its Consolidated Balance Sheet, however, it does not expect the guidance to have a material impact on its Consolidated Statements of Operations or Cash Flows.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230)," which clarifies the presentation and classification of eight specific issues on the cash flow statement. This ASU is effective for public businesses for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company adopted the new guidance in the first quarter of fiscal 2019. The adoption of this ASU did not have a material impact on the Company's Consolidated Financial Statements.

In March 2017, the FASB issued ASU No. 2017-07, "Compensation-Retirement Benefits (Topic 715)," which amended its guidance related to the presentation of net periodic pension cost and net periodic postretirement benefit cost. The amended guidance requires the service cost component be disaggregated from the other components of net benefit cost. The service cost component of expense is required to be reported in the Statement of Operations in the same line item as other compensation costs within income from operations. The other components of net benefit cost are required to be presented separately from the service cost component outside of income from operations. The amended guidance also allows only the service cost component of net benefit cost to be eligible for capitalization. This ASU is effective for public businesses for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The Company adopted the amended guidance in the first quarter of fiscal 2019. The amended guidance was applied retrospectively for the presentation of the service cost component and other components of net benefit cost in the Consolidated Statements of Operations and Retained Earnings. In addition, the amended guidance was applied prospectively for the capitalization of the service cost component of net benefit cost. The amended guidance allows for a practical expedient that permits the use of amounts previously disclosed in the Employee Benefit Plans Note to the Consolidated Financial Statements within prior comparative periods as the estimation basis for applying the retrospective presentation requirements. The Company elected this practical expedient for the prior period presentation. The adoption of this amended guidance resulted in the reclassification of net

benefit income of $89 and $30 from compensation costs included in Cost of products sold and Selling, general and administrative expense, respectively, to Other income in the Consolidated Statement of Operations and Retained Earnings for the three months ended December 31, 2017 and the reclassification of net benefit income of $266 and $92 from compensation costs included in Cost of products sold and Selling, general and administrative expense, respectively, to Other income in the Consolidated Statement of Operations and Retained Earnings for the nine months ended December 31, 2017.

In August 2018, the FASB issued ASU No. 2018-14, "Compensation-Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20)," which removes disclosures that no longer are considered cost beneficial, clarifies specific disclosure requirements and adds disclosure requirements identified as relevant for defined benefit pension and other postretirement benefit plans. This amendment is effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The amendment requires application on a retrospective basis to all periods presented. The Company believes the adoption of this ASU will not have a material impact on its Consolidated Financial Statements.

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

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**
(Dollar amounts in thousands, except per share data)

**Overview**

We are a global business that designs, manufactures and sells critical equipment for the energy, defense and chemical/petrochemical industries. Our energy markets include oil refining, cogeneration, nuclear and alternative power. For the defense industry, our equipment is used in nuclear propulsion power systems for the U.S. Navy. For the chemical and petrochemical industries, our equipment is used in fertilizer, ethylene, methanol and downstream chemical facilities.

Graham's global brand is built upon our world-renowned engineering expertise in vacuum and heat transfer technology, responsive and flexible service and high quality standards. We design and manufacture custom-engineered ejectors, vacuum pumping systems, surface condensers and vacuum systems. We are also a leading nuclear code accredited fabrication and specialty machining company. We supply components used inside reactor vessels and outside containment vessels of nuclear power facilities. Our equipment can also be found in other diverse applications such as metal refining, pulp and paper processing, water heating, refrigeration, desalination, food processing, pharmaceutical, and heating, ventilating and air conditioning.

Our corporate headquarters are located in Batavia, New York. We have production facilities co-located with our headquarters in Batavia and at our wholly-owned subsidiary, Energy Steel & Supply Co. ("Energy Steel"), located in Lapeer, Michigan. We also have a wholly-owned foreign subsidiary, Graham Vacuum and Heat Transfer Technology (Suzhou) Co., Ltd. ("GVHTT"), located in Suzhou, China. GVHTT provides sales and engineering support for us in the People's Republic of China and management oversight throughout Southeast Asia. In the third quarter of fiscal 2019, we established Graham India Private Limited ("GIPL") as a wholly-owned subsidiary. GIPL, located in Ahmedabad, India, will serve as a sales and market development office focusing on the refining, petrochemical and fertilizer markets.

Our current fiscal year (which we refer to as "fiscal 2019") ends March 31, 2019.

**Highlights**

Highlights for the three and nine months ended December 31, 2018 include:

- Net sales for the third quarter of fiscal 2019 were $17,198, compared with $17,281 for the third quarter of the fiscal year ended March 31, 2018 (we refer to the fiscal year ended March 31, 2018 as "fiscal 2018"). Net sales for the first nine months of fiscal 2019 were $68,190, up 23% compared with net sales of $55,356 for the first nine months of fiscal 2018.
- Net income (loss) and income (loss) per diluted share for the third quarter of fiscal 2019 were $95 and $0.01, respectively, compared with ($11,622) and ($1.19), respectively, for the third quarter of fiscal 2018 (for the third quarter of fiscal 2018. Excluding the non-cash impairment and other charges related to the commercial nuclear power business as well as the impact of the 2017 Tax Cuts and Jobs Act (the "Tax Act"), net income (loss) and income (loss) per diluted share in the third quarter of fiscal 2018 were ($1) and ($0.00). Net income and income per diluted share for the first nine months of fiscal 2019 were $4,245 and $0.43, respectively, compared with a net loss of ($10,677) and loss per diluted share of ($1.09) for the first nine months of fiscal 2018. Excluding the impairment and other charges related to our commercial nuclear power business, the impact of the Tax Act change, as well as restructuring charges, net income and income per diluted share for the first nine months of fiscal 2018 were $1,168 and $0.12.
- Orders booked in the third quarter of fiscal 2019 were $23,169, down 43% compared with the third quarter of fiscal 2018 when orders were $40,528. Orders booked in the first nine months of fiscal 2019 were $79,562, up 16% compared with the first nine months of fiscal 2018, when orders were $68,679.
- Backlog was a record at $133,694 at December 31, 2018, compared with $127,796 at September 30, 2018 and $117,946 at March 31, 2018.
- Gross profit margin and operating margin for the third quarter of fiscal 2019 were 22% and (3%) respectively, compared with 20% and (89%), respectively, for the third quarter of fiscal 2018. Gross profit margin and operating margin for the first nine months of fiscal 2019 were 25% and 5%, respectively, compared with 22% and (26%), respectively, for the first nine months of fiscal 2018.
- Cash and short-term investments at December 31, 2018 were $80,407, compared with $78,989 on September 30, 2018 and $76,479 at March 31, 2018.

**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 Part II, Item 1A of this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for fiscal 2018.

Forward-looking statements may also include, but are not limited to, statements about:

- the current and future economic environments affecting us and the markets we serve;
- expectations regarding investments in new projects by our customers;
- sources of revenue and anticipated revenue, including the contribution from anticipated growth;
- expectations regarding achievement of revenue and profitability expectations;
- plans for future products and services and for enhancements to existing products and services;
- our operations in foreign countries;
- political instability in regions in which our customers are located;
- tariff and trade relations issues between the United States and its trading partners;
- our ability to affect our growth and acquisition strategy;
- our ability to expand nuclear power work into new markets;
- our ability to maintain or expand nuclear power work for the U.S. Navy;
- our ability to successfully execute our existing contracts;
- estimates regarding our liquidity and capital requirements;
- timing of conversion of backlog to sales;
- our ability to attract or retain customers;
- the outcome of any existing or future litigation; and
- our ability to increase our productivity and capacity.

Forward-looking statements are usually accompanied by words such as "anticipate," "believe," "estimate," "may," "might," "intend," "interest," "appear," "expect," "suggest," "plan," "predict," "project," "should," "will," "encourage," "potential," "contemplate," "continue," "could" and similar expressions. Actual results could differ materially from historical results or those implied by the forward-looking statements contained in this report.

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

**Current Market Conditions**

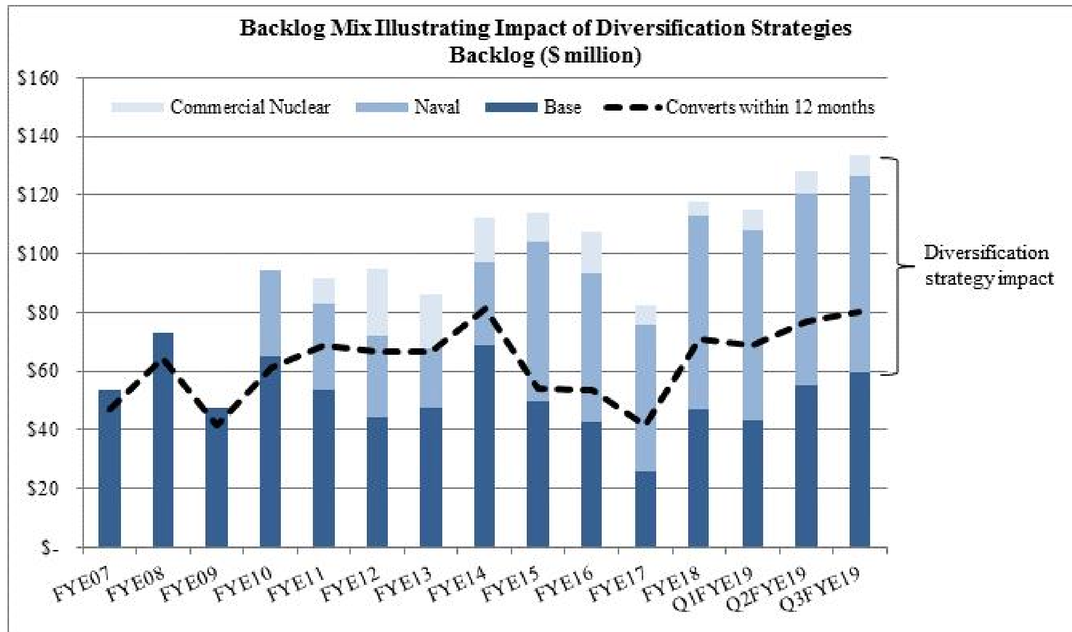
Our global energy and petrochemical markets, which had been in a significant downturn for three years, began to show signs of stabilization and improvement during the second half of fiscal 2018. The stabilization and improvement, as well as subsequent increases in crude oil prices and improvement in general global economic conditions, have led to increased activity by our customers in the downstream energy sector. Although crude oil prices have been volatile for the past few months, the increased level of activity from customers has continued. Customers have begun to invest in upgrading and turnaround maintenance for existing facilities and, in certain geographies, are beginning to look at new capacity. While this additional activity is encouraging, we cannot predict the pace at which a recovery will progress or if it will continue. Capital spending in the nuclear market, for both new capacity and to maintain existing facilities, continues to be weak.

Our long-term view for the global energy and petrochemical markets is that general economic fundamentals will drive increasing demand and result in continued capital investment to satisfy increasing global energy demand. These fundamentals include rising populations, strong emerging market economic growth, and overall global economic expansion.

Our naval nuclear propulsion market has demand tied to aircraft carrier and submarine vessel construction schedules of the primary shipyards who service the U.S. Navy. We expect growth in our naval nuclear propulsion business to result from our strategic actions to increase our market share, our successful performance, and expected increases in demand.

We believe the long-term outlook in our key markets supports our growth plans. In the near term, new order levels are expected to remain variable, resulting in both relatively strong and weak periods. However, we believe order activity will be significantly improved compared with the recent downturn.

The chart below shows the impact of our diversification strategy. Over 55% of our current backlog is from markets not served by us in the fiscal 2007-2009 time frame.




*FYE refers to fiscal year ended March 31

**Results of Operations**

To better understand the significant factors that influenced our performance during the periods presented, 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 Part I, 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 December 31, | | Nine Months Ended December 31, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Net sales | $ 17,198 | $ 17,281 | $ 68,190 | $ 55,356 |
| Gross profit | $ 3,742 | $ 3,496 | $ 17,111 | $ 12,015 |
| Gross profit margin | 22% | 20% | 25% | 22% |
| SG&A expense (1) | $ 4,308 | $ 4,096 | $ 13,696 | $ 11,539 |
| SG&A as a percent of sales | 25% | 24% | 20% | 21% |
| Net income (loss) | $ 95 | $ (11,622) | $ 4,245 | $ (10,677) |
| Diluted income (loss) per share | $ 0.01 | $ (1.19) | $ 0.43 | $ (1.09) |
| Total assets | $ 156,761 | $ 138,623 | $ 156,761 | $ 138,623 |
| Total assets excluding cash, cash equivalents and investments | $ 76,354 | $ 64,441 | $ 76,354 | $ 64,441 |

(1)Selling, general and administrative expense is referred to as "SG&A".

**The Third Quarter and First Nine Months of Fiscal 2019 Compared With the Third Quarter and First Nine Months of Fiscal 2018**

Sales for the third quarter of fiscal 2019 were $17,198, as compared with sales of $17,281 for the third quarter of fiscal 2018. Our domestic sales, as a percentage of aggregate product sales, were 83% in the third quarter of fiscal 2019 compared with 65% in the third quarter of fiscal 2018. Domestic sales year-over-year increased $3,019, or 27%. International sales decreased $3,102, or 52%, in the third quarter of fiscal 2019 compared with the third quarter of fiscal 2018. Sales in the three months ended December 31, 2018 were 39% to the refining industry, 17% to the chemical and petrochemical industries, 15% to the power industry, including the nuclear market, and 29% to other commercial and industrial applications, including the U.S. Navy. Sales in the three months ended December 31, 2017 were 31% to the refining industry, 24% to the chemical and petrochemical industries, 10% to the power industry, including the nuclear market, and 35% to other commercial and industrial applications, including the U.S. Navy. Fluctuations in sales among markets, products and geographic locations can vary measurably from quarter-to-quarter based on timing and magnitude of projects. See also "Current Market Conditions," above. For additional information on anticipated future sales and our markets, see "Orders and Backlog" below.

Sales for the first nine months of fiscal 2019 were $68,190, an increase of $12,834, or 23% compared with sales of $55,356 for the first nine months of fiscal 2018. Our domestic sales, as a percentage of aggregate product sales, were 63% in the first nine months of fiscal 2019 compared with 67% in the same period in fiscal 2018. Domestic sales increased $5,570, or 15%, while international sales increased by $7,264, or 40%. International sales accounted for 37% and 33% of total sales for the first nine months of fiscal 2019 and fiscal 2018, respectively. Sales in the first nine months of fiscal 2019 were 53% to the refining industry, 14% to the chemical and petrochemical industries, 12% to the power industry, including the nuclear market, and 21% to other commercial and industrial applications, including the U.S. Navy. Sales in the first nine months of fiscal 2018 were 25% to the refining industry, 30% to the chemical and petrochemical industries, 14% to the power industry, including the nuclear market, and 31% to other commercial and industrial applications, including the U.S. Navy.

Our gross profit margin for the third quarter of fiscal 2019 was 22% compared with 20% for the third quarter of fiscal 2018. Gross profit for the third quarter of fiscal 2019 increased 7% compared with fiscal 2018, to $3,742 from $3,496. Gross profit was impacted by improved pricing and higher margin projects, but partially offset by under-absorbed production costs, which have increased to support more production capacity.

Our gross profit margin for the first nine months of fiscal 2019 was 25% compared with 22% for the first nine months of fiscal 2018. Gross profit for the first nine months of fiscal 2019 increased 42% compared with fiscal 2018, to $17,111 from $12,015. The increase in gross profit was due to higher volume and improved pricing compared with the prior year, partially offset by increased production costs.

SG&A expenses as a percent of sales for the three and nine-month periods ended December 31, 2018 were 25% and 20%, respectively. SG&A expenses in the third quarter of fiscal 2019 were $4,308, an increase of $212, or 5%, compared with the third quarter of fiscal 2018 SG&A expenses of $4,096. SG&A expenses in the first nine months of fiscal 2019 were $13,696, an increase of $2,157, or 19%, compared with the first nine months of fiscal 2018 SG&A expenses of $11,539. The increases in the three and nine month periods ending December 31, 2018 are primarily due to headcount additions and variable compensation related to improved sales and profitability.

In the first nine months of fiscal 2018, we incurred a pre-tax restructuring charge of $316 ($224 after tax) for severance costs related to certain headcount reductions. No comparable charge was incurred in fiscal 2019.

Interest income for the three and nine-month periods ended December 31, 2018 was $404 and $1,044, respectively, compared with $142 and $455, respectively, for the same periods ended December 31, 2017. Interest expense for the three and nine-month periods ended December 31, 2018 was $5 and $8, respectively, compared with $3 and $8, respectively, for the same periods ended December 31, 2017.

Our effective tax rate for the three-month period ended December 31, 2018 was not meaningful due to the proximity of our results to breakeven. This yielded a tax credit of $56 on pre-tax income of $39. The effective tax rate in the three months ending December 31, 2017 was also not a meaningful comparison due to the cumulative adjustment required due to the change in U.S. federal tax rates from the Tax Act signed into law on December 22, 2017.

Our effective tax rate for the nine-month period ended December 31, 2018 was 16%. This compares to the effective tax rate in the nine-month period ended December 31, 2017 of 23%.

Net income and income per diluted share for the third quarter of fiscal 2019 were $95 and $0.01, compared with ($11,622) and ($1.19), respectively, for the third quarter of fiscal 2018. Excluding impairment and other related charges for our commercial nuclear

business, as well as the gain from implementation of the Tax Act, net loss and loss per diluted share for the third quarter of fiscal 2018 were ($1) and ($0.00), respectively.

Net income and income per diluted share for the first nine months of fiscal 2019 were $4,245 and $0.43, respectively, compared with net loss and loss per diluted share for the first nine months of fiscal 2018 were ($10,677) and ($1.09), respectively. Excluding the items noted above as well as restructuring charges in each year, net income and income per diluted share for the first nine months of fiscal 2018 were $1,168 and $0.12, respectively.

**Liquidity and Capital Resources**

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

| | December 31, 2018 | March 31, 2018 |
|---|---|---|
| Cash and investments | $ 80,407 | $ 76,479 |
| Working capital | 78,676 | 78,105 |
| Working capital ratio[1] | 2.6 | 3.1 |
| Working capital excluding cash and investments | (1,731) | 1,626 |
| Working capital excluding cash and investments as a percent of net sales[2] | (1.9)% | 2.1% |

(1) Working capital ratio equals current assets divided by current liabilities.
(2) Working capital excluding cash and investments as a percent of net sales is based upon trailing twelve month sales.

Net cash generated by operating activities for the first nine months of fiscal 2019 was $8,535, compared with $3,874 for the first nine months of fiscal 2018. The increase in cash generation year over year was attributable to improved net income, an improvement in accounts receivable and inventory partially offset by greater changes in an increase in unbilled revenue and decrease in accounts payable.

Dividend payments and capital expenditures in the first nine months of fiscal 2019 were $2,851 and $1,471, respectively, compared with $2,638 and $543, respectively, for the first nine months of fiscal 2018.

Capital expenditures for fiscal 2019 are expected to be between approximately $2,000 and $2,500. Approximately 75% to 80% of our fiscal 2019 capital expenditures are expected to be for machinery and equipment, with the remaining amounts expected to be used for other items.

Cash and investments were $80,407 on December 31, 2018 compared with $76,479 on March 31, 2018, up $3,928.

We invest net cash generated from operations in excess of cash held for near-term needs in short-term, less than 365 days, certificates of deposit, money market accounts or U.S. government instruments, generally with maturity periods of up to 180 days. Our money market account is used to securitize our outstanding letters of credit, which reduces our cost on those letters of credit. Approximately 95% of our cash and investments are held in the U.S. The remaining 5% is invested in our China operations.

Our revolving credit facility with JP Morgan Chase provides us with a line of credit of $25,000, including letters of credit and bank guarantees. In addition, our JP Morgan Chase agreement allows us to increase the line of credit, at our discretion, up to another $25,000, for total availability of $50,000. Borrowings under this credit facility are secured by all of our assets. We also have a $5,000 unsecured line of credit with HSBC, N.A. Letters of credit outstanding on December 31, 2018 and March 31, 2018 were $7,158 and $8,233, respectively. The outstanding letters of credit as of December 31, 2018 were issued by JP Morgan Chase, HSBC, as well as Bank of America (under our previous credit facility). There were no other amounts outstanding on our credit facilities at December 31, 2018 and March 31, 2018. The borrowing rate under our JP Morgan Chase facility as of December 31, 2018 was the bank's prime rate, or 5.50%. Availability under the JP Morgan Chase and HSBC lines of credit was $24,991 and $24,336 at December 31, 2018 and March 31, 2018, respectively. We believe that cash generated from operations, combined with our investments and available financing capacity under our credit facility, will be adequate both to meet our cash needs for the immediate future and to support our growth strategies.

**Orders and Backlog**

Orders for the three-month period ended December 31, 2018 were $23,169 compared with $40,528 for the same period in the prior year, a decrease of 43%. The third quarter of fiscal 2018 included a unique commercial order which required high cost specialized materials. The majority of the decrease from fiscal 2018 is attributable to this order. Orders represent written communications received from customers requesting us to supply products and/or services. Domestic orders were 50% of total orders, or $11,623, and international orders were 50% of total orders, or $11,546, in the current quarter compared with the third quarter of fiscal 2018, when domestic orders were 47%, or $19,144, of total orders, and international orders were 53%, or $21,384, of total orders.

During the first nine months of fiscal 2019, orders were $79,562, compared with $68,679 for the same period of fiscal 2018, an increase of $10,883, or 16%. For the first nine months of fiscal 2019, chemical and petrochemical orders increased by $19,814, power orders increased $2,047, refining decreased by $5,910 and other commercial and industrial applications, including the U.S. Navy, decreased by $5,068. See “Current Market Conditions” for additional information above.

Backlog was $133,694 at December 31, 2018, compared with $127,796 at September 30, 2018, a 5% increase. Backlog is defined as the total dollar value of orders received for which revenue has not yet been recognized. Approximately 50% to 55% of orders currently in our backlog are expected to be converted to sales within one year, 10% to 20% are expected to ship between 12 and 24 months, and 30% to 40% beyond two years. The majority of the orders that are expected to convert beyond twelve months are for the U.S. Navy. At December 31, 2018, 23% of our backlog was attributable to equipment for refinery project work, 20% for chemical and petrochemical projects, 5% for power projects, including nuclear, 50% for U.S. Navy projects and 2% for other industrial applications. At December 31, 2017, 35% of our backlog was attributed to equipment for refinery project work, 4% for chemical and petrochemical projects, 6% for power projects, 51% for U.S. Navy projects and 4% for other industrial applications. At December 31, 2018, we had no projects on hold.

**Outlook**

Capital spending in the energy markets we serve began to increase during the second half of fiscal 2018. Orders from customers in the refining market were much stronger in the second half of fiscal 2018 than the previous nine quarters. Orders in the chemical and petrochemical market did not exhibit similar growth during the second half of fiscal 2018, but increased during the first nine months of fiscal 2019. Although orders in the commercial nuclear market improved in the first nine months of fiscal 2019, they remain weak. At December 31, 2018, 50% of our backlog was for the U.S. Navy. Our pipeline continues to be robust, but quarterly fluctuations in order levels are likely to occur.

We continue to believe in the long-term strength of the energy and petrochemical markets. Coupled with our diversification strategy with the U.S. Navy and the power market, we believe this long-term strength in our markets will support our goal to significantly grow our business. We have invested in capacity to serve our commercial customers as well as to expand the work we do for the U.S. Navy. We intend to continue to look for organic growth opportunities as well as acquisitions or other business combinations that we believe will allow us to expand our presence in both our existing and ancillary markets. We are focused on reducing earnings volatility, growing our business and diversifying our business and product lines.

We expect revenue in fiscal 2019 to be approximately $90,000 to $95,000. We project that approximately 50% to 55% of our current backlog will convert to sales in the next twelve months. We expect the remaining backlog will convert beyond twelve months, which includes a combination of U.S. Navy orders that have a long conversion cycle (up to five years) as well as certain commercial orders.

We expect gross profit margin in fiscal 2019 to be in the 25% to 27% range, compared with 22% in fiscal 2018. SG&A during fiscal 2019 is expected to be between $18,250 and $18,750. Our effective tax rate during fiscal 2019 is expected to be approximately 20%.

We expect that full year cash flow in fiscal 2019 will remain strong.

**Contingencies and Commitments**

We have been named as a defendant in lawsuits alleging personal injury from exposure to asbestos allegedly contained in or accompanying our products. We are a co-defendant with numerous other defendants in these lawsuits and intend to vigorously defend ourselves against these claims. The claims in our current lawsuits are similar to those made in 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 immaterial amounts.

As of December 31, 2018, we are subject to the claims noted above, as well as other legal proceedings and potential claims that have arisen in the ordinary course of business. Although the outcome of the lawsuits, legal proceedings or potential claims to which we are or may become a party cannot be determined and an estimate of the reasonably possible loss or range of loss cannot be made, we do not believe that the outcomes, either individually or in the aggregate, will have a material effect on our results of operations, financial position or cash flows.

**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 accounting 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 and establishment of operational milestones which are used to recognize revenue under the percentage-of-completion method, fair value estimates of identifiable tangible and intangible assets acquired in business combinations, 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" included in our Annual Report on Form 10-K for the year ended March 31, 2018.

**Off Balance Sheet Arrangements**

We did not have any off balance sheet arrangements as of December 31, 2018 or March 31, 2018, other than operating leases and letters of credit.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

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

The assumptions applied in preparing the following qualitative and quantitative disclosures regarding foreign currency exchange rate, price risk and project cancellation 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 three months and nine months ended December 31, 2018 were 17% and 37%, respectively, of total sales compared with 35% and 33%, respectively, for the same period of fiscal 2018. 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 U.S. dollars. In the three and nine months of fiscal years ended December 31, 2018 and 2017, all sales by us and our wholly-owned subsidiaries, for which we were paid, were denominated in the local currency of the respective subsidiary (U.S. dollars or Chinese RMB).

We have limited exposure to foreign currency purchases. In the first three and nine months of fiscal 2019, our purchases in foreign currencies represented 4% and 2% of cost of products sold, respectively. In each of the first three and nine months of fiscal 2018, our purchases in foreign currencies represented 1% of cost of products sold. At certain times, we may enter into forward foreign currency exchange agreements to hedge our exposure against potential unfavorable changes in foreign currency values on significant sales and purchase contracts negotiated in foreign currencies. Forward foreign currency exchange contracts were not used in the periods being reported on in this Quarterly Report on Form 10-Q and as of December 31, 2018 and March 31, 2018, we held no forward foreign 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. Depending on where our markets are in the cycle, we can experience strong or weak price levels.

**Project Cancellation and Project Continuation Risk**

Open orders are reviewed continuously through communications with customers. If it becomes evident to us that a project is delayed well beyond its original shipment date, management will move the project into "placed on hold" (i.e., suspended) category. Furthermore, if a project is cancelled by our customer, it is removed from our backlog. We attempt to mitigate the risk of cancellation by structuring contracts with our customers to maximize the likelihood that progress payments made to us for individual projects cover the costs we have incurred. As a result, we do not believe we have a significant cash exposure to projects which may be cancelled. At December 31, 2018, we had no projects on hold.

## Item 4. Controls and Procedures

*Conclusion regarding the effectiveness of disclosure controls and procedures*

Our President and Chief Executive Officer (principal executive officer) and Vice President-Finance & Administration and Chief Financial Officer (principal financial officer) each have evaluated the effectiveness of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934, as amended) 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 Vice President-Finance & Administration and Chief Financial 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.

PART II - OTHER INFORMATION

**Item 1A. Risk Factors**

The following risk factors include any material changes to the Company's previously disclosed risk factors contained in Part I, Item 1A of our Annual Report on Form 10-K for fiscal 2018. Any risk factor that has not been updated or included below remains as previously reported in Part I, Item 1A of the Annual Report on Form 10-K for fiscal 2018 and no material changes to such risk factors have occurred since the filing of such report.

***Tariffs imposed by the U.S. and those imposed in response by other countries, including China, as well as rapidly changing trade relations, could materially and adversely affect our business and results of operations.***

Changes in U.S. and foreign governments' trade policies have resulted and may continue to result in tariffs on imports into, and exports from, the U.S. Throughout 2018, the U.S. imposed tariffs on imports from several countries, including China, Canada, the European Union and Mexico. In response, China, Canada and the European Union have proposed or implemented their own tariffs on certain exports from the U.S. into those countries. Tariffs affecting our products and product components, including raw materials we use, particularly high-end steel and steel related products, may add significant costs to us and make our products more expensive. As a result, our products could become less attractive to customers outside the U.S. and our profit margins negatively impacted. Accordingly, continued tariffs may weaken relationships with certain of our trading partners and may adversely affect our financial performance and results of operations. When beneficial to us, we may consider alternate sourcing options, including off shore subcontracting, in order to minimize the impact of the tariffs. Because we conduct aspects of our business in China through our subsidiary, potential reductions in trade with China and diminished relationships between China and the U.S., as well as the continued escalation of tariffs, could have a material adverse effect on our business and results of operations.

***The current, and any future, lapse in U.S. government appropriations has disrupted, and may in the future disrupt, U.S. export processing and related procedures and, as a result, may materially and adversely affect our revenue, results of operations and business.***

The impact of the lapse in U.S. federal appropriations which commenced on December 22, 2018, and any such future lapse (each, a "Government Shutdown") could negatively affect our ability to ship finished products to customers. We rely on federal government personnel, who are not able to perform their duties during a Government Shutdown, to conduct routine business processes related to the inspection and delivery of our products, process export licenses for us and perform other services for us that, when disrupted, may prevent us from timely shipping products outside the U.S. If we are unable to timely ship our products outside the U.S., there could be a material adverse impact on our results of operations and business. Moreover, our inability to ship products, or the perception by customers that we might not be able to timely ship our products in the future, may cause such customers to look to foreign competitors to fulfill their demand. If our customers look to foreign competitors to source equipment of the type we manufacture, there could be a material adverse impact on our results of operations and business.

**Item 6.** **Exhibits**

| | | |
|---|---|---|
| (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 Certification | |
| + | 32.1 | Section 1350 Certifications |
| (101) | Interactive Data File | |
| + | 101.INS | XBRL Instance Document |
| + | 101.SCH | XBRL Taxonomy Extension Schema Document |
| + | 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| + | 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| + | 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| + | 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

\+ Exhibit filed with 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/ Jeffrey Glajch
Jeffrey Glajch
Vice President-Finance & Administration and
Chief Financial Officer

Date: February 1, 2019

EXHIBIT 31.1

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

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: February 1, 2019

/s/ James R. Lines
James R. Lines
President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF
PRINCIPAL FINANCIAL OFFICER

I, Jeffrey Glajch, 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

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: February 1, 2019

/s/ Jeffrey Glajch
Jeffrey Glajch
Vice President-Finance & Administration and
Chief Financial Officer

EXHIBIT 32.1

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 ended December 31, 2018 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: February 1, 2019

/s/Jeffrey Glajch
Jeffrey Glajch
Vice President-Finance & Administration and
Chief Financial Officer
(Principal Financial Officer)
Date: February 1, 2019

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.