GRAHAM CORP
Form 10-K
June 01, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended March 31, 2016

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____________ to ___________.

Commission File Number 1-8462

GRAHAM CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	16-1194720
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20 Florence Avenue, Batavia, New York	14020
(Address of principal executive offices)	(Zip Code)

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

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

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

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

Title of Class

Preferred Stock Purchase Rights

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

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

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

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

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

Indicate by checkmark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act:

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of September 30, 2015, the last business day of the registrant's most recently completed second fiscal quarter, was $168,783,420. The market value calculation was determined using the closing price of the registrant’s common stock on September 30, 2015, as reported on the NYSE (the exchange on which the registrant’s common stock is listed). For purposes of the foregoing calculation only, all directors, officers and the Employee Stock Ownership Plan of the registrant have been deemed affiliates.

As of May 23, 2016, the registrant had outstanding 9,646,981shares of common stock, $.10 par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement, to be filed in connection with the registrant's 2016 Annual Meeting of Stockholders to be held on July 28, 2016, are incorporated by reference into Part III, Items 10, 11, 12, 13 and 14 of this filing.

Table of Contents

GRAHAM CORPORATION

Annual Report on Form 10-K

Year Ended March 31, 2016

Note: Portions of the registrant's definitive Proxy Statement, to be issued in connection with the registrant's 2016 Annual Meeting of Stockholders to be held on July 28, 2016, are incorporated by reference into Part III, Items 10, 11, 12, 13 and 14 of this Annual Report on Form 10-K.

2

PART I

(Dollar amounts in thousands except per share data)

Item 1. Business

Graham Corporation ("we," "us," "our") is 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 customer 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, 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 also 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.

We were incorporated in Delaware in 1983 and are the successor to Graham Manufacturing Co., Inc., which was incorporated in New York in 1936. As of March 31, 2016, we had 368 employees. Our stock is traded on the NYSE under the ticker symbol "GHM".

Unless indicated otherwise, dollar figures in this Annual Report on Form 10-K are reported in thousands.

Our Products, Customers and Markets

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

- Petroleum Refining
  - ¾ conventional oil refining
  - ¾ oil sands extraction and upgrading
- Defense
  - ¾ propulsion systems for nuclear-powered aircraft carriers and submarines
- Chemical and Petrochemical Processing
  - ¾ fertilizer plants
  - ¾ ethylene, methanol and nitrogen producing plants
  - ¾ plastics, resins and fibers plants
  - ¾ downstream petrochemical plants

¾ coal-to-chemicals plants
¾ gas-to-liquids plants

·Power Generation /Alternative Energy

¾ nuclear power generation
¾ fossil fuel plants
¾ biomass plants
¾ cogeneration power plants
¾ geothermal power plants
¾ ethanol plants

·Other

¾ soap manufacturing plants

3

¾ air conditioning and water heating systems
¾ food processing plants
¾ pharmaceutical plants
¾ liquefied natural gas production facilities

Our principal customers include end users of our products in their manufacturing, refining and power generation processes, large engineering companies that build installations for companies in such industries, and the original equipment manufacturers, who combine our products with their equipment prior to its sale to end users.

Our products are sold by a team of sales engineers we employ directly as well as by independent sales representatives located worldwide. There may be short periods of time, a fiscal year for example, where one customer may make up greater than 10% of our business. However, if this occurs in multiple years, it is usually not the same customer or project over such a multi-year period.

Over a business cycle, our domestic sales will generally range between 35% and 60% of total sales. The mix of domestic and international sales can vary from year to year.

A breakdown of our net sales by geographic area and product class for our fiscal years ended March 31, 2016, 2015 and 2014, which we refer to as "fiscal 2016," "fiscal 2015" and "fiscal 2014", respectively, is contained in Note 13 to our consolidated financial statements included in Item 8 of Part II of this Annual Report on Form 10-K and such breakdown is incorporated into this Item 1 by reference. We refer to our fiscal year ending March 31, 2017 as "fiscal 2017". Our backlog at March 31, 2016 was $107,963, compared with $113,811 at March 31, 2015.

Our Strengths

Our core strengths include:

- We have a value-enhancing sales and development platform. Our customer-facing platform of sales, project estimating and application engineering are competitive advantages. We have tools and capabilities to iterate quickly and comprehensively as customers evaluate how best to integrate our equipment into their facilities. We find our early and deep involvement adds significant value to the process and is an important competitive differentiator in the long sales cycle industries we serve. Customers need our engineering and fabrication expertise early in project life cycle to understand how best to specify our equipment.
- We are renowned for our strong capabilities to handle complex, custom orders. The orders we receive are extremely complex and the order management platforms in our businesses provide a second competitive differentiator for our company. Typically there is intense interaction between our project management teams and the end user or its engineering firm as product design and quality requirements are finalized after an order is placed. We have built strong capabilities to successfully execute high quality, engineered-to-order and build-to-spec process-critical equipment. In our markets, order administration, risk management, cost containment, quality and engineering documentation are as important as the equipment itself. Supplier selection process begins with assessing whether a supplier can manage all aspects of an order.
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We maintain a responsive, flexible production environment. The operations platform in our businesses is adept at handling low volume, high mix orders that are highly customized fabrications. Our production environment is much different from a highly engineered standard products business. While equipment within product may look similar, rarely are two alike. Also, during production it is not uncommon for customer-driven engineering changes to occur that alter the configuration of what had been initially released into production. The markets that we serve demand this flexible operating model.

- We provide robust after-the-sale technical support. Our engineering and service personnel go to customer sites to audit the performance of our equipment, provide operator training and troubleshoot performance issues. Technical service after a sale is important to our customer as their focus is always on leveraging to maximize equipment capabilities.
- We have a highly trained workforce. We maintain a long-tenured, highly skilled and extremely flexible workforce.
- We have a strong balance sheet. We maintain significant cash and investments on hand, and no bank debt, which we believe provides us with the flexibility to pursue our business strategy, including growth by acquisition.

- We have a high quality credit facility. Our credit facilities provide us with a $30,000 borrowing capacity that is expandable at our option to provide us with up to a total of $55,000 in borrowing capacity.

Our Strategy

We intend to strategically leverage and deploy our assets, including but not limited to, financial, technical, manufacturing and know-how, in order to capture expanded market share within the geographies and industries we serve, expand revenue opportunities in adjacent and countercyclical markets and continually improve our results of operations in order to:

- Generate sustainable earnings growth;
- Reduce earnings volatility;
- Improve our operating performance;
- Generate strong cash flow from operations;
- Meet or exceed our customers’ expectations;
- Improve the value we provide to our customers; and
- Provide an acceptable return to our shareholders

To accomplish our objectives and maintain strategic focus, we believe that we must:

- Successfully deploy corporate assets to expand our market share in the industries we currently serve, access and develop a stronger presence in industries where we do not have a historically strong presence, and pursue acquisitions, partnerships and/or other business combinations in order to enter new geographic or industrial markets, new product lines or expand our coverage in existing markets.
- Identify organic growth opportunities and consummate acquisitions where we believe the strength of the Graham and Energy Steel brands will provide us with the ability to expand and complement our core businesses. We intend to extend our existing product lines, move into complementary product lines and expand our global sales presence in order to further broaden our existing markets and reach additional markets.

- Expand our market penetration in the domestic nuclear power industry. We also intend to identify additional domestic and international opportunities to serve the commercial nuclear power industry.
- Expand our market presence in the U.S. Navy's Nuclear Propulsion Program. We plan to demonstrate our proficiency by successfully executing the complex Nuclear Propulsion Program orders that are currently in our backlog by controlling both cost and risk, providing high-quality custom fabrication to exacting military quality control requirements and through disciplined project management. We intend to become a preferred supplier of equipment to the U.S. Navy’s Nuclear Propulsion Program for both surface and submarine vessels.
- Continue to invest in people and capital equipment to meet the anticipated long-term growth in demand for our products in the oil refining, petrochemical processing and power generation industries, especially in emerging markets.
- Continue to deliver the highest quality products and solutions that enable our customers to achieve their operating objectives. We believe that our high quality and technical expertise differentiates us from our competitors and allows us to win new orders based on value.

In order to effectively implement our strategy, we also believe that we must continually invest in and leverage our unique customer value enhancing differentiators, the keys of which are listed below:

- Invest in engineering resources and technology in order to advance our vacuum and heat transfer technology market penetration.
  - Enhance our engineering capacity and capability, especially in connection with product design, in order to more quickly respond to existing and future customer demands.

- Invest in our manufacturing operations to improve productivity where needed and identify out-sourced capacity to complement our growth strategies.
- Accelerate our ability to quickly and efficiently bid on available projects through our ongoing implementation of front-end bid automation and design processes.
- Expand our capabilities and penetrate the existing sales channel and customer base in the nuclear market.
- Invest in resources to further serve the U.S. Navy in our core competency areas of engineering and manufacturing, where our commercial capabilities meet U.S. Navy requirements.
- Implement and expand upon our operational efficiencies through ongoing refinement of our flexible manufacturing flow model as well as achievement of other cost efficiencies.
- Focus on improving quality to eliminate errors and rework, thereby reducing lead time.
- Develop a cross-trained, flexible workforce able to adjust to variable product demand by our customers.

Competition

Our business is highly competitive. The principal bases on which we compete include technology, price, performance, reputation, delivery, and quality. Our competitors listed in alphabetical order by market include:

North America

Market	Principal Competitors
Refining vacuum distillation	Croll Reynolds Company, Inc.; Gardner Denver, Inc.; GEA Wiegand GmbH
Chemicals/petrochemicals	Croll Reynolds Company, Inc.; Gardner Denver, Inc.; Schutte Koerting
Turbomachinery Original Equipment Manufacturer ("OEM") – refining, petrochemical	Ambassador; Donghwa Entec Co., Ltd..; KEMCO; Oeltechnik GmbH; SPX Heat Transfer
Turbomachinery OEM – power and power producer	Holtec; KEMCO; Maarky Thermal Systems; SPX Heat Transfer; Thermal Engineering International (USA), Inc.
Nuclear	Consolidated; Dubose; Energy & Process; Joseph Oat; Nova; Nusource; Tioga
Navy Nuclear Propulsion Program / Defense	DC Fabricators; Joseph Oat; PCC; Triumph Aerospace; Xylem

international

Market	Principal Competitors
Refining vacuum distillation	Edwards, Ltd.; Gardner Denver, Inc.; GEA Wiegand GmbH; Korting Hannover AG

Chemicals/petrochemicals	Croll Reynolds Company, Inc.; Edwards, Ltd.; Gardner Denver, Inc.; GEA Wiegand GmbH; Korting Hannover AG; Schutte Koerting
Turbomachinery OEM – refining, petrochemical	Chem Process Systems; Donghwa Entec Co., Ltd.; Hangzhou Turbine Equipment Co., Ltd.; KEMCO; Mazda (India); Oeltechnik GmbH
Turbomachinery OEM – power and power producer	Chem Process Systems; Holtec; KEMCO; Mazda (India);
	SPX Heat Transfer; Thermal Engineering International

Intellectual Property

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

Availability of Raw Materials

Historically, we have not been materially adversely impacted by the availability of raw materials.

Working Capital Practices

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

Environmental Matters

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

Seasonality

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

Research and Development Activities

During fiscal 2016, fiscal 2015 and fiscal 2014, we spent $3,746, $3,585 and $3,436, respectively, on research and development activities related both to new products and services and the ongoing improvement of existing products and services.

Information Regarding International Sales

The sale of our products outside the U.S. accounted for a significant portion of our total revenue during our last three fiscal years. Approximately 37%, 36% and 38% of our revenue in fiscal 2016, fiscal 2015 and fiscal 2014, respectively, resulted from foreign sales. Sales in Asia constituted approximately 10%, 8% and 11% of our revenue in fiscal 2016, fiscal 2015 and fiscal 2014, respectively. Sales in the Middle East constituted approximately 12%, 8% and 4% of our revenue in fiscal 2016, fiscal 2015 and fiscal 2014, respectively. Our foreign sales and operations are subject to numerous risks, as discussed under the heading "Risk Factors" in Item 1A of Part I and elsewhere in this Annual Report on Form 10-K.

Employees

As of March 31, 2016, we had 368 employees. We believe that our relationship with our employees is good.

Available Information

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

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

Item 1A. Risk Factors

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

Risks related to our business

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

A substantial portion of our revenue is derived from the sale of our products to companies in the chemical, petrochemical, petroleum refining and power generating industries and to the U.S. Navy, or to firms that design and construct facilities for these industries. The core industries in which our products are used are highly cyclical and have historically experienced severe downturns. The dramatic decline and the continued volatility in global oil prices has translated into an abrupt contraction in orders in the energy markets and is the most recent example of the cyclical nature of our markets. We believe that over the long-term, demand for our products is expanding in the petrochemical, petroleum refining and power generating industries, however, the current decline and volatility in oil prices confirms that cyclical downturns will occur periodically. A sustained deterioration in any of the industries we serve would materially harm our business and operating results because our customers would not likely have the resources necessary to purchase our products, nor would they likely have the need to build additional facilities or improve existing facilities. A cyclical downturn can occur suddenly and result in extremely different financial performance sequentially from quarter to quarter or on an annual comparative basis due to an inability to rapidly adjust costs.

The markets we serve include the petroleum refining and petrochemical industries. These industries are both highly cyclical in nature and dependent on the price of crude oil and natural gas as well as on the differential between the two prices. As a result, volatility in the prices of oil and natural gas may negatively impact our operating results.

The prices of crude oil and natural gas have historically been very volatile, as evidenced by the extreme volatility in oil prices over the past two years. This volatility caused a steep decline in orders from the energy markets over that period. The increased supply and reduction in price of natural gas in North America has also caused a significant change in the global energy markets in the past few years. During times of significant volatility in the market for crude oil or natural gas, our customers often refrain from placing orders until the market stabilizes. If our customers refrain from placing orders with us, our revenue would decline and there could be a material adverse effect on our business and results of operations. Despite the near-term current volatility, we believe the global consumption of crude oil and natural gas will increase over the course of the next 20 years and that such increased consumption will result in continual increases in global capacity. Many of our products are purchased in connection with oil refinery construction, revamps and upgrades to expand global capacity.

The relative costs of oil, natural gas, nuclear power, hydropower and numerous forms of alternative energy production may have a material adverse impact on our business and operating results.

Global and regional energy supply comes from many sources, including oil, natural gas, coal, hydro, nuclear, solar, wind, geothermal and biomass, among others. A cost or supply shift among these sources could negatively impact our business opportunities going forward and the profitability of those opportunities. A demand shift, where technological advances favor the utilization of one or a few sources of energy may also impact the demand for our products. If demand shifts in a manner that increases energy utilization outside of our traditional customer base or expertise, our business and financial results could be materially adversely affected. In addition, governmental policy can affect the relative importance of various forms of energy sources. For example, non-fossil based sources may require and often receive government tax incentives to foster investment. If these incentives become more prominent, our business and results of operations could suffer.

Our business is highly competitive. If we are unable to successfully implement our business strategy and compete against entities with greater resources than us or against competitors who have a relative cost advantage, we risk losing market share to current and future competitors.

We encounter intense competition in all of our markets. Some of our present and potential competitors may have substantially greater financial, marketing, technical or manufacturing resources. Our competitors may also be able to respond more quickly to new technologies or processes and changes in customer demands and they may be able to devote greater resources towards the development, promotion and sale of their products. Certain of our competitors may also have a cost advantage compared to us and may compete against us based on price. This may affect our ability to secure new business and maintain our level of profitability. In addition, our current and potential competitors may make strategic acquisitions or establish cooperative relationships among themselves or with third parties that increase their ability to address the needs of our customers. Moreover, customer buying patterns can change if customers become more price sensitive and accepting of lower cost suppliers. If we cannot compete successfully against current or future competitors, our business will be materially adversely affected.

A change in our end use customers, our markets, or a change in the engineering procurement and construction companies serving our markets could harm our business and negatively impact our financial results.

Although we have long-term relationships with many of our end use customers and with many engineering, procurement and construction companies, the project management requirements, pricing levels and costs to support each customer and customer type are often different. Our customers have historically focused on the quality of the engineering and product solutions which we have provided to them. As our markets continue to grow, and new market opportunities expand, we could see a shift in pricing as a result of facing competitors with lower production costs, which may have a material adverse impact on our results of operations and financial results. In certain developing geographies, the relative importance of cost versus quality may lead to decisions which look at short-term costs instead of total long-term cost of operations.

The loss of, or significant reduction or delay in, purchases by our largest customers could reduce our revenue and adversely affect our results of operations.

A small number of customers has accounted for a substantial portion of our historical net sales. For example, sales to our top ten customers , who can vary each year, accounted for 30%, 38% and 32% of consolidated net sales in fiscal 2016, fiscal 2015 and fiscal 2014, respectively. We expect that a limited number of customers will continue to represent a substantial portion of our sales for the foreseeable future. The loss of any of our major customers, a decrease or delay in orders or anticipated spending by such customers or a delay in the production of existing orders could materially adversely affect our revenues and results of operations.

We may experience customer concentration risk related to strategic growth for U.S. Navy projects

Our strategy to increase the penetration of U.S. Navy related opportunities could lead to U.S. Navy related projects becoming greater than 10% of our total revenue. While these projects are spread across multiple contractors for the U.S. Navy, the end customer for these projects is the same. This concentration of business could add additional risk to Graham should there be a disruption, short or long term, in the funding for these projects or our participation in the U.S. Navy Nuclear Propulsion program.

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

For fiscal 2016, 37% of our revenue was from customers located outside of the U.S. Moreover, we maintain a subsidiary and a sales office in China. We believe that revenue from the sale of our products outside the U.S. will continue to account for a significant portion of our total revenue for the foreseeable future. We intend to continue to expand our international operations to the extent that suitable opportunities become available. Our foreign operations and sales could be adversely affected as a result of:

- nationalization of private enterprises and assets;
- political or economic instability in certain countries and regions, such as the ongoing instability throughout the Middle East and/or portions of the former Soviet Union;

- political relationships between the U.S. and certain countries and regions;
- differences in foreign laws, including increased difficulties in protecting intellectual property and uncertainty in enforcement of contract rights;
- the possibility that foreign governments may adopt regulations or take other actions that could directly or indirectly harm our business and growth strategy;
- credit risks;
- currency fluctuations;
- tariff and tax increases;
- export and import restrictions and restrictive regulations of foreign governments;

- shipping products during times of crisis or wars;
- our failure to comply with U.S. laws regarding doing business in foreign jurisdictions, such as the Foreign Corrupt Practices Act; or
- other factors inherent in maintaining foreign operations.

Global demand growth could be led by emerging markets, which could result in lower profit margins and increased competition.

The increase in global demand could be led by emerging markets. If this is the case, we may face increased competition from lower cost suppliers, which in turn could lead to lower profit margins on our products. Customers in emerging markets may also place less emphasis on our high quality and brand name than do customers in the U.S. and certain other industrialized countries where we compete. If we are forced to compete for business with customers that place less emphasis on quality and brand recognition than our current customers, our results of operations could be materially adversely affected.

Climate change and greenhouse gas regulations may affect our customers' investment decisions.

Due to concern over the risk of climate change, a number of countries have adopted, or are considering the adoption of, regulatory frameworks to reduce greenhouse gas emissions. These restrictions may affect our customers' abilities and willingness to invest in new facilities or to re-invest in current operations. These requirements could impact the cost of our customers' products, lengthen project implementation times, and reduce demand for hydrocarbons, as well as shift hydrocarbon demand toward lower-carbon sources. Any of the foregoing could adversely impact the demand for our products, which in turn could have an adverse effect on our business and results of operation.

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

We conduct our business in China primarily through our wholly-owned Chinese subsidiary. The results of operations and future prospects of our Chinese subsidiary are subject to evolving economic, political and social developments in China. In particular, the results of operations of our Chinese subsidiary may be adversely affected by, among other things, changes in China's political, economic and social conditions, changes in policies of the Chinese government, changes in laws and regulations or in the interpretation of existing laws and regulations, changes in foreign exchange regulations, measures that may be introduced to control inflation, such as interest rate increases, and changes in the rates or methods of taxation. In addition, changes in demand could result from increased competition from local Chinese manufacturers who have cost advantages or who may be preferred suppliers for Chinese end users. Also, Chinese commercial laws, regulations and interpretations applicable to non-Chinese owned market participants, such as us, are continually changing. These laws, regulations and interpretations could impose restrictions on our ownership or operations of our interests in China and have a material adverse effect on our business and results of operations.

Intellectual property rights are difficult to enforce in China, which could harm our business.

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

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

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

Changes in U.S. and foreign energy policy regulations could adversely affect our business.

Energy policy in the U.S. and in the other countries where we sell our products is evolving rapidly and we anticipate that energy policy will continue to be an important legislative priority in the jurisdictions where we sell our products. It is difficult, if not impossible, to predict the changes in energy policy that could occur, as they may be related to changes in political administration, public policy or other factors. The elimination of, or a change in, any of the current rules and regulations in any of our markets could create a regulatory environment that makes our end users less likely to purchase our products, which could have a material adverse effect on our business. Government subsidies or taxes, which favor or disfavor certain energy sources compared with others, could have a material adverse effect on our business and operating results.

Efforts to reduce large U.S. federal budget deficits could result in government cutbacks in defense spending or in reduced incentives to pursue alternative energy projects, resulting in reduced demand for our products, which could harm our business and results of operations.

Our business strategy calls for us to continue to pursue defense-related projects as well as projects for end users in the alternative energy markets in the U.S. In recent years the U.S. federal government has incurred large budget deficits. In the event that U.S. federal government defense spending is reduced or alternative energy related incentives are reduced or eliminated in an effort to reduce federal budget deficits, projects related to defense or alternative energy may become less plentiful. The impact of such reductions could have a material adverse effect on our business and results of operations, as well as our growth opportunities.

U.S. Navy orders are subject to annual government funding. A disruption in funding could adversely impact our business.

One of our growth strategies is to increase our penetration of U.S. Navy related opportunities. Projects for the U.S. Navy and its contractors generally have a much longer order-to-shipment time period than our commercial orders. The time between the awarding of an order to complete shipment can take three to six years. Annual government funding is required to continue the production of this equipment. Disruption of government funding, short or long term, could impact the ability for us to continue our production activity on these orders. Since this business is expected to increase as a percentage of our overall business, such a disruption, should it occur, could adversely impact the sales and profitability of our business.

Changes in the competitive environment for U.S. Navy procurement could adversely impact our ability to grow this business.

As we have expanded our addressable opportunities, this has caused a change in the supply chain for these products. We would expect continued changes to occur as our customers continue to consider supplier concentration issues and the risk which this may lead to for them. Competitor response to our market penetration is also a concern. In addition, our ability to expand beyond the U.S. Navy to grow with certain NATO customers may further impact the market dynamics.

Political and regulatory developments could make the utilization and growth of nuclear power as an energy source less desirable, which would harm our business and results of operations.

A global event, such as a major earthquake or terrorist activity, may impact the desirability of operating existing nuclear power plants or building new or replacement nuclear plants facilities. Should public opinion or political pressure result in the closing of existing nuclear facilities or otherwise result in the failure of the nuclear power industry to grow, especially within the U.S., the business, results of operations and growth prospects in the nuclear market could be materially adversely impacted.

In addition, the U.S. Nuclear Regulatory Commission, or NRC, performs operational and safety reviews of nuclear facilities in the U.S. It is possible that the NRC could take actions or impose regulations that adversely affect the demand for our products and services, or otherwise delay or prohibit construction of new nuclear power generation facilities, even temporarily. If any such event were to occur, our business or operations could be materially adversely impacted.

Near term income statement impact from competitive contracts could adversely affect our operating results.

During weaker market periods, we may choose to be more aggressive in pricing certain competitive projects to protect or gain market share or to increase the utilization of our facilities. In these situations, it is possible that an incrementally profitable order may be unprofitable from an accounting perspective when including fixed manufacturing costs. In these situations, we are required to recognize the financial loss at time of order acceptance, or as soon as our cost estimates are updated, whichever occurs first. It is possible we may accumulate losses either on a large project or more than one project such that, in a short time period, for example, a reporting quarter, these losses may have a meaningful impact on the earnings of the period.

Our operating results could be adversely affected by customer contract cancellations and delays.

The value of our backlog as of March 31, 2016 was $107,963. Our backlog can be significantly affected by the timing of large orders. The amount of our backlog at March 31, 2016 is not necessarily indicative of future backlog levels or the rate at which our backlog will be recognized as sales. Although historically the amount of modifications and terminations of our orders has not been material compared with our total contract volume, customers can, and sometimes do, terminate or modify their orders. This generally occurs more often in times of end market or capital market turmoil. As evidence of this, we had three orders totaling $12,095 cancelled during fiscal 2016 and, including the fourth quarter of fiscal 2015, $17,990 were cancelled during the past five quarters. We cannot predict whether cancellations will occur or accelerate in the future. Although certain of our contracts in backlog may contain provisions allowing for us to assess cancellation charges to our customers to compensate us for costs incurred on cancelled contracts, cancellations of purchase orders or modifications made to existing contracts could substantially and materially reduce our backlog and, consequently, our future sales and results of operations. Moreover, delay of contract execution by our customers can result in volatility in our operating results.

Our current backlog contains a number of large orders from the U.S. Navy project. In addition, we are continuing to pursue business in these end markets which offer large multi-year projects which have an added risk profile beyond that of our historic customer base. A delay, long-term extension or cancellation of any of these projects could have a material adverse effect on our business and results of operations.

Our exposure to fixed-price contracts and the timely completion of such contracts could negatively impact our results of operations.

A substantial portion of our sales is derived from fixed-price contracts, which may involve long-term fixed price commitments by us to our customers. While we believe our contract management processes are strong, we nevertheless could experience difficulties in executing large contracts, including but not limited to, estimating errors, cost overruns, supplier failures and customer disputes. To the extent that any of our fixed-price contracts are delayed, our subcontractors fail to perform, contract counterparties successfully assert claims against us, the original cost estimates in these or other contracts prove to be inaccurate or the contracts do not permit us to pass increased costs on to our customers, our profitability may decrease or losses may be incurred which, in turn, could have a material adverse effect on our business and results of operations.

Given our size and specialization of our business, if we lose any member of our management team and we experience difficulty in finding a qualified replacement, our business could be harmed.

Competition for qualified management and key technical and sales personnel in our industry is intense. Moreover, our technology is highly specialized and it may be difficult to replace the loss of any of our key technical and sales personnel. Many of the companies with which we compete for management and key technical and sales personnel have greater financial and other resources than we do or are located in geographic areas which may be considered by some to be more desirable places to live. If we are not able to retain any of our key management, technical or sales personnel, it could have a material adverse effect on our business and results of operations.

During certain high demand periods, there can be a shortage of skilled production workers, especially those with high-end welding capabilities. We could experience difficulty hiring or replacing those individuals, which could adversely affect our business.

Our fabrication processes require highly skilled production workers, especially welders. Welding has not been an educational field that has been popular over the past few decades as manufacturing has moved overseas. If we are unable to retain, hire or train an adequate number of individuals with high-end welding capability, this could adversely impact our ability to achieve our financial objectives. In addition, if demand for highly skilled production workers were to significantly outstrip supply, wages for these skilled workers could dramatically increase in our and related industries and that could affect our financial performance.

Our acquisition strategy may not be successful or may increase business risk.

The success of our acquisition strategy will depend, in part, on our ability to identify suitable companies or businesses to purchase and then successfully negotiate and close acquisition transactions. In addition, our success depends in part on our ability to integrate acquisitions and realize the anticipated benefits from combining the acquisition with our historical business, operations and management. We cannot provide any assurances that we will be able to complete any acquisitions and then successfully integrate the business and operations of those acquisitions without encountering difficulties, including unanticipated costs, difficulty in retaining customers and supplier or other relationships, failure to retain key employees, diversion of our management’s attention, failure to integrate information and accounting systems or establish and maintain proper internal control over financial reporting. Moreover, as part of the integration process, we must incorporate an acquisition’s existing business culture and compensation structure with our existing business. If we are not able to efficiently integrate an acquisition’s business and operations into our organization in a timely and efficient manner, or at all, the anticipated benefits of the acquisition may not be realized, or it may take longer to realize these benefits than we currently expect, either of which could have a material adverse effect on our business or results of operations.

Should a portion of our intangible assets be impaired, results of operations could be materially adversely affected.

Our balance sheet includes intangible assets, including goodwill and other separately identifiable intangible assets, primarily as a result of our acquisition of Energy Steel which make up 15% of the assets of the company. The value of our intangible assets may increase in the future if we complete additional acquisitions as part of our overall business strategy. We are required to review our intangible assets for impairment on an annual basis, or more frequently if certain indicators of permanent impairment arise. Factors that could indicate that our intangible assets are impaired could include, among other things, a decline in our stock price and market capitalization, lower than projected operating results and cash flows, and slower than expected growth rates in our markets. If a portion of our intangible assets becomes impaired as a result of such a review, the impaired portion of such assets would have to be written-off during that period. Such a write-off could have a material adverse effect on our business and results of operations.

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

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

Provisions contained in our contracts with customers that attempt to limit our damages may not be enforceable or may fail to protect us from liability for damages and we may not negotiate such contractual limitations of liability in certain circumstances. Our insurance may not cover all liabilities and our historical experience may not reflect liabilities we may face in the future. Our risk of liability may increase as we manufacture more complex or larger projects. We also may not be able to continue to maintain such insurance at a reasonable cost or on reasonable terms, or at all. Any material liability not covered by provisions in our contracts or by insurance could have a material adverse effect on our business and financial condition.

Furthermore, if a customer suffers damage as a result of an event related to one of our products, even if we are not at fault, they may reduce their business with us. We may also incur significant warranty claims, which are not covered by insurance. In the event a customer ceases doing business with us as a result of a product malfunction or defect, perceived or actual, or if we incur significant warranty costs in the future, there could be a material adverse effect on our business and results of operations.

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

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

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

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

We are exposed to the risk of currency fluctuations between the U.S. dollar and the currencies of the countries in which we sell our products to the extent that such sales are not based on U.S. dollars. 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.

Strength of the U.S. dollar compared with the Euro or Asian currencies may put us in a less competitive position. 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. While we may enter into currency exchange rate hedges from time to time to mitigate these types of fluctuations, we cannot remove all fluctuations or hedge all exposures and our earnings are impacted by changes in currency exchange rates. In addition, if the counter-parties to such exchange contracts do not fulfill their obligations to deliver the contractual foreign currencies, we could be at risk for fluctuations, if any, required to settle the obligation. Any of the foregoing could adversely affect our business and results of operations. At March 31, 2016, we held no forward foreign currency exchange contracts.

Security threats and other sophisticated computer intrusions could harm our information systems, which in turn could harm our business and financial results.

We utilize information systems and computer technology throughout our business. We store sensitive data, proprietary information and perform engineering designs and calculations on these systems. Information systems are subject to threats and sophisticated computer crimes, which pose a risk to the stability and security of our business. A failure or breach in security could expose our company as well as our customers and suppliers to risks of misuse of information, compromising confidential information and technology, destruction of data, production disruptions and other business risks which could damage our reputation, competitive position and financial results of our operations. In addition, defending ourselves against these threats may increase costs or slow operational efficiencies of our business. If any of the foregoing were to occur, it could have a material adverse effect on our business and results of operations.

We face potential liability from asbestos exposure and similar claims that could result in substantial costs to us as well as divert attention of our management, which could have a material adverse effect on our business and results of operations.

We are a defendant in a number of lawsuits alleging illnesses from exposure to asbestos or asbestos-containing products and seeking unspecified compensatory and punitive damages. We cannot predict with certainty the outcome of these lawsuits or whether we could become subject to any similar, related or additional lawsuits in the future. In addition, because some of our products are used in systems that handle toxic or hazardous substances, any failure or alleged failure of our products in the future could result in litigation against us. For example, a claim could be made under various regulations for the adverse consequences of environmental contamination. Any litigation brought against us, whether with or without merit, could result in substantial costs to us as well as divert the attention of our management, which could have a material adverse effect on our business and results of operations.

Many of our large international customers are nationalized or state-owned businesses. Any failure to comply with the United States Foreign Corrupt Practices Act could adversely impact our competitive position and subject us to penalties and other adverse consequences, which could harm our business and results of operations.

We are subject to the United States Foreign Corrupt Practices Act, which generally prohibits U.S. companies from engaging in bribery or making other prohibited payments to foreign officials for the purpose of obtaining or retaining business. Many foreign companies, including some of our competitors, are not subject to these prohibitions. Corruption, extortion, bribery, pay-offs, theft and other fraudulent practices occur from time-to-time in certain of the jurisdictions in which we may operate or sell our products. While we strictly prohibit our employees and agents from engaging in such conduct and have established procedures, controls and training to prevent such conduct from occurring, it is possible that our employees or agents will engage in such conduct and that we might be held responsible. If our employees or other agents are alleged or are found to have engaged in such practices, we could incur significant costs and suffer severe penalties or other consequences that may have a material adverse effect on our business, financial condition and results of operations.

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

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

- We could issue shares of preferred stock with terms adverse to our common stock. Under our certificate of incorporation, our Board of Directors is authorized to issue shares of preferred stock and to determine the rights, preferences and privileges of such shares without obtaining any further approval from the holders of our common stock. We could issue shares of preferred stock with voting and conversion rights that adversely affect the voting power of the holders of our common stock, or that have the effect of delaying or preventing a change in control of our company.

- Only a minority of our directors may be elected in a given year. Our bylaws provide for a classified Board of Directors, with only approximately one-third of our Board elected each year. This provision makes it more difficult to effect a change of control because at least two annual stockholder meetings are necessary to replace a majority of our directors.
- Our bylaws contain advance notice requirements. Our bylaws also provide that any stockholder who wishes to bring business before an annual meeting of our stockholders or to nominate candidates for election as directors at an annual meeting of our stockholders must deliver advance notice of their proposals to us before the meeting. Such advance notice provisions may have the effect of making it more difficult to introduce business at stockholder meetings or nominate candidates for election as director.
- Our certificate of incorporation requires supermajority voting to approve a change of control transaction. Seventy-five percent of our outstanding shares entitled to vote are required to approve any merger, consolidation, sale of all or substantially all of our assets and similar transactions if the other party to such transaction owns 5% or more of our shares entitled to vote. In addition, a majority of the shares entitled to vote not owned by such 5% or greater stockholder are also required to approve any such transaction.
- Amendments to our certificate of incorporation require supermajority voting. Our certificate of incorporation contains provisions that make its amendment require the affirmative vote of both 75% of our outstanding shares entitled to vote and a majority of the shares entitled to vote not owned by any person who may hold 50% or more of our shares unless the proposed amendment was previously recommended to our stockholders by an affirmative vote of 75% of our Board. This provision makes it more difficult to implement a change to our certificate of incorporation that stockholders might otherwise consider to be in their best interests without approval of our Board.
- Amendments to our bylaws require supermajority voting. Although our Board of Directors is permitted to amend our bylaws at any time, our stockholders may only amend our bylaws upon the affirmative vote of both 75% of our outstanding shares entitled to vote and a majority of the shares entitled to vote not owned by any person who owns 50% or more of our shares. This provision makes it more difficult for our stockholders to implement a change they may consider to be in their best interests without approval of our Board.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Our corporate headquarters, located at 20 Florence Avenue, Batavia, New York, consists of a 45,000 square foot building. Our manufacturing facilities, also located in Batavia, consist of approximately 33 acres and contain about 260,000 square feet in several buildings, including 206,000 square feet in manufacturing facilities, 48,000 square feet for warehousing and a 6,000 square-foot building for product research and development. We also lease approximately 15,000 square feet of office space and 45,000 square feet of manufacturing facilities for our subsidiary, Energy Steel, located in Lapeer, Michigan. Additionally, we lease an approximately 1,500 square foot U.S. sales office in Houston, Texas and GVHTT leases an approximately 4,900 square foot sales and engineering office in Suzhou, China.

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

Item 3.Legal Proceedings

The information required by this Item 3 is contained in Note 17 to our consolidated financial statements included in Item 8 of Part II of this Annual Report on Form 10-K and is incorporated herein by reference.

Item 4.Mine Safety Disclosures

Not applicable.

PART II

(Amounts in thousands, except per share data)

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

Our common stock is traded on the NYSE exchange under the symbol “GHM”. As of May 23, 2016, there were 9,646,981 shares of our common stock outstanding that were held by approximately 141 stockholders of record.

The following table shows the high and low per share prices of our common stock for the periods indicated.

	High	Low
Fiscal year 2016		
First quarter	$25.25	$19.82
Second quarter	20.60	15.71
Third quarter	18.88	15.63
Fourth quarter	20.24	14.39
Fiscal year 2015		
First quarter	$34.88	$26.20
Second quarter	35.35	27.99
Third quarter	34.65	26.06
Fourth quarter	28.86	20.58

(1) The historical prices for our common stock prior to May 2, 2014 are based on the high and low per share prices on the NYSE MKT exchange, where our common stock was then listed. On such date, our common stock began trading on the NYSE.

Subject to the rights of any preferred stock we may then have outstanding, the holders of our common stock are entitled to receive dividends as may be declared from time to time by our Board of Directors out of funds legally available for the payment of dividends. Dividends declared per share by our Board of Directors for the first, second, third and fourth quarters of fiscal 2016 were $.08, $.08, $.08 and $.09, respectively. Dividends declared per share for the first, second, third and fourth quarters of fiscal 2015 were $.04, $.04, $.04 and $.08, respectively. There can be no assurance that we will pay cash dividends in any future period or that the level of cash dividends paid by us will remain constant.

Our senior credit facility contains provisions pertaining to the maintenance of a maximum funded debt to earnings before interest expense, income taxes, depreciation and amortization, or EBITDA, ratio and a minimum level of earnings before interest expense and income taxes to interest ratio as well as restrictions on the payment of dividends to stockholders. The facility limits the payment of dividends to stockholders to 25% of net income if our funded debt to EBITDA ratio is greater than 2.0 to 1. As of March 31 and May 31, 2016 we did not have any funded debt outstanding. More information regarding our senior credit facility can be found in Note 7 to the Consolidated Financial Statements included in Item 8 of Part II of this Annual Report on Form 10-K.

We maintain a stock repurchase program that permits us to repurchase up to $18,000 of our common stock from time to time, either in the open market or through privately negotiated transactions. Common stock repurchases in the quarter ended March 31, 2016 were as follows:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Program
1/01/2016 – 1/31/2016	58	$ 15.88	$ 11,232
2/01/2016 – 2/29/2016	153	$ 17.49	$ 8,559
3/01/2016 – 3/31/2016	—	$ —	$ 8,559
Total	211	$ 17.05	$ 8,559

Item 6. Selected Financial Data
GRAHAM CORPORATION – FIVE YEAR SUMMARY OF SELECTED FINANCIAL DATA

(Amounts in thousands, except per share data)

(for fiscal years ended March 31)

	2016	2015	2014	2013	2012
Operations:					
Net sales	$90,039	$135,169	$102,218	$104,973	$103,186
Gross profit	23,255	41,804	31,812	31,822	32,635
Gross profit percentage	25.8 %	30.9 %	31.1 %	30.3 %	31.6 %
Net income	6,131	14,735	10,145	11,148	10,553
Cash dividends	3,296	2,026	1,308	899	793
Common stock:					
Basic earnings from continuing operations per share	$0.61	$1.46	$1.01	$1.11	$1.06
Diluted earnings from continuing operations per share	0.61	1.45	1.00	1.11	1.06
Stockholders' equity per share	11.34	11.50	10.49	9.30	8.20
Dividends declared per share	0.33	.20	.13	.09	.08
Market price range of common stock					
High	25.25	35.35	41.94	24.80	26.30
Low	14.39	20.58	22.36	16.20	14.36
Average common shares outstanding – diluted	9,983	10,143	10,104	10,051	9,998
Financial data at March 31:					
Cash and cash equivalents and investments	$65,072	$60,271	$61,146	$51,692	$41,688
Working capital	74,807	80,884	70,678	64,330	54,937
Capital expenditures	1,153	5,300	5,263	1,655	3,243
Depreciation	2,201	2,079	1,977	1,851	1,685
Total assets	143,131	154,003	140,971	126,514	114,918
Long-term debt, including capital lease obligations	157	98	136	127	203
Stockholders' equity	109,380	116,551	105,908	92,995	81,620

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations
(Amounts in thousands, except per share data)

Overview

We are a global 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, 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 also 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.

Highlights

Highlights for our fiscal year ended March 31, 2016, which we refer to as “fiscal 2016” include:

- Net income and income per diluted share for fiscal 2016, were $6,131 and $0.61 compared with net income and income per diluted share of $14,735 and $1.45, respectively, for the fiscal year ended March 31, 2015, which we refer to as “fiscal 2015.” Net income and income per diluted share for fiscal 2015 were $15,899 and $1.57 excluding the impact of a nonrecurring restructuring charge.
- Net sales for fiscal 2016 were $90,039, down 33% compared with $135,169 for fiscal 2015.
- Operating cash flow for fiscal 2016 was $18,751, up from $6,279 in fiscal 2015.
- Orders received in fiscal 2016 were $83,997, down 38% compared with fiscal 2015, when orders were $136,533, which included a large U.S. Navy order.
- Backlog on March 31, 2016 was at $107,963, down 5% from backlog of $113,811 on March 31, 2015.
- Gross profit and operating margins for fiscal 2016 were 25.8% and 9.4% compared with 30.9% and 16.0%, respectively, for fiscal 2015. Fiscal 2015 operating margin was 17.2%, excluding the impact of nonrecurring restructuring expenses.
- In fiscal 2016 $12,737 was returned to shareholders from a combination of share repurchases and dividends; 539 shares were repurchased at a cost of $9,441. Dividends of $3,296 were paid to shareholders in fiscal 2016. No

shares were repurchased in fiscal 2015 and dividends of $2,026 were paid in fiscal 2015.

- Cash and cash equivalents and short-term investments at March 31, 2016 were $65,072 compared with $60,271 as of March 31, 2015, an increase of $4,801.
- At fiscal 2016 year end, we had a solid balance sheet that was free of bank debt and which we believe provides us with the financial flexibility to pursue our business strategy.

Forward-Looking Statements

This report and other documents we file with the Securities and Exchange Commission ("SEC") include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended.

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

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

- the current and future economic environments affecting us and the markets we serve;
- 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;
- 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," "encourage," "potential" 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

Demand for our products and services to the oil refining and chemical industries depends on capital investment for new capacity, retrofit and debottlenecking projects and for planned or unplanned maintenance activity. Increased volatility and significant reduction in global crude oil prices beginning in the second half of calendar 2014 has caused uncertainty in the oil refining and chemical industries. The dramatic reduction and increased volatility in global crude oil prices has caused a significant slowdown in investment by our oil refining and chemical industry customers. These markets have altered their investment timing over the past year due to this sustained lower price and volatility of crude oil. Capital investment within global refining and chemical industries contracted during fiscal 2016 compared with fiscal 2015 and is projected to be down further in fiscal 2017. In the near term, we believe that the catalyst for increased investment would likely be higher or more stable crude oil prices. However, if crude oil prices remain low for a sustained period, we expect increased global energy demand would eventually drive additional investment regardless of crude oil prices.

Demand for our products and services in the nuclear power utility market is affected by investment in maintenance, repair, life extension and nuclear regulatory mandated investment along with global investment in new capacity. Global investment in new capacity is affected by regional legislative policy and comparative cost per unit of power output with other energy sources, such as natural gas, oil or alternative energies. Although the nuclear market which we serve is very fragmented, we continue to believe that it provides an important opportunity for our growth, especially via market share gains.

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 based on our strategic actions to increase our market share and expected demand.

Strategic investment and continued concentration of effort on oil refining and chemical markets will have a long-term perspective, notwithstanding the severity of the current downturn in these markets. We believe that long-term demand drivers for energy requirements are unchanged and have not been affected by the recent price of crude oil. We believe that such demand, which is driven by population growth and an expanding middle class in emerging markets, requires an increase in global energy capacity and investment. Our strategy is to continue to leverage our investments and expand our capabilities and execution capacity to grow market share in the oil refining, chemical and nuclear markets, as well as our business with the U.S. Navy. For more information, refer to the heading “Strategy and Outlook” within this Item 7 of this Annual Report on Form 10-K.

We believe the long-term outlook in our key markets supports our strategy to grow our revenue to over $200,000 across the next business cycle in our markets. In the near term, new order levels are expected to remain volatile, resulting in both relatively strong and weak periods.

The chart below shows the impact of our diversification strategy.   Over 60% of our backlog at the end of fiscal year 2016 is from markets not served in the Fiscal 2007-2009 time frame.

Results of Operations

For an understanding of the significant factors that influenced our performance, the following discussion should be read in conjunction with our consolidated financial statements and the notes to our consolidated financial statements included in Item 8 of Part II of this Annual Report on Form 10-K.

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

	Year Ended March 31,		
	2016	2015	2014
Net sales	$90,039	$135,169	$102,218
Net income	$6,131	$14,735	$10,145
Diluted income per share	$0.61	$1.45	$1.00
Total assets	$143,131	$154,003	$140,971

Fiscal 2016 Compared with Fiscal 2015

Sales for fiscal 2016 were $90,039, down $45,130 or 33%, as compared with sales of $135,169 for fiscal 2015. Domestic sales were $57,027 or 63% of total sales, down from $86,399 or 64% of total sales in fiscal 2015. Domestic sales decreased $29,372, or 34%, compared with fiscal 2015 across all end markets. International sales accounted for $33,012 or 37% of total sales for fiscal 2016, down from $48,770, or 36%, of total sales in fiscal 2015. International sales decreased $15,758, or 32%, compared with fiscal 2015. All international markets were weaker, with the largest decreases occurring in Canada, South and Central America and Asia. By market, sales for fiscal 2016 were 32% to the refining industry, the same as in fiscal 2015, 33% to the chemical and petrochemical industries, down from 35% in fiscal 2015, 16% to the power markets, up from 15% in fiscal 2015, and 19% to defense and other industrial applications, up from 18% in fiscal 2015.

Our gross margin for fiscal 2016 was 25.8% compared with 30.9% for fiscal 2015. The reduction in gross margin was driven by (1) lower facility utilization due to the 33% reduction in sales; (2) a very competitive pricing environment; and (3) costs incurred ahead of revenue for our Navy and nuclear strategies. Gross profit for fiscal 2016 decreased $18,549, or 44% compared with fiscal 2015 due to lower sales volume as well as the items which affected gross margin.

Selling, general and administrative, or SG&A, expense for fiscal 2016 was $16,565, down 11% or $1,947, compared with $18,512 in fiscal 2015. SG&A as a percentage of sales in fiscal 2016 increased to 18.4% of sales compared with 13.7% of sales in fiscal 2015. The increase as a percent of sales was due to lower sales levels in fiscal 2016, partly offset by cost reductions.

In the prior year, fiscal 2015, we also incurred a pre-tax restructuring charge of $1,718 ($1,164 after tax) for severance costs related largely to a voluntary early retirement program we offered in the fourth quarter of fiscal 2015 and to certain involuntary headcount reductions which occurred in the same quarter. The cost reductions in fiscal 2016 SG&A were partly due to this restructuring as well as lower selling, commission and other compensation expenses related to lower sales and earnings.

Other income in fiscal 2016 was $1,789. This was due to cancellation fees received from customers primarily for two orders totaling $7,168 which were cancelled in fiscal 2016. There was no other income in fiscal 2015.

Interest income for fiscal 2016 was $261, up from $189 in fiscal 2015. Interest expense for fiscal 2016 was $10 compared with $11 in fiscal 2015.

Our effective tax rate in fiscal 2016 was 30% compared with an effective tax rate of 32% for fiscal 2015. This decrease in rates was due to the retroactive reinstatement of the R&D tax credit.

Net income for fiscal 2016 and income per diluted share was $6,131 and $0.61, respectively. Net income in fiscal 2015 was $14,735 or $1.45 per diluted share, and excluding the impact of the restructuring charge, was $15,899 and $1.57, respectively.

Fiscal 2015 Compared with Fiscal 2014

Sales for fiscal 2015 were $135,169, up $32,951 or 32%, as compared with sales of $102,218 for fiscal 2014. Domestic sales were $86,399 or 64% of total sales, up from $63,850 or 62% of total sales in fiscal 2014. Domestic sales increased $22,549, or 35%, compared with fiscal 2014 driven principally by new capacity investment in the U.S. chemical industry. International sales accounted for $48,770 or 36% of total sales for fiscal 2015, up from $38,368, or 38%, of total sales in fiscal 2014. International sales increased $10,402, or 27%, compared with fiscal 2014. By market, sales for fiscal 2015 were 32% to the refining industry, down from 35% in fiscal 2014, 35% to the chemical and petrochemical industries, up from 24% in fiscal 2014, 15% to the power markets, down from 23% in fiscal 2014, and 18% to defense and other industrial applications, the same as in fiscal 2014.

Our gross margin for fiscal 2015 was 30.9% compared with 31.1% for fiscal 2014. Leverage from 33% greater revenue in 2015 versus 2014 was muted by lower pricing for certain orders and the extent of subcontracting that was required due to timing of customer requirements and near-term capacity limitations. Gross profit for fiscal 2015 increased $9,992, or 31% compared with fiscal 2014 due to higher sales volume.

Selling, general and administrative, or SG&A, expense for fiscal 2015 was $18,512, up 8% or $1,317, compared with $17,195 in fiscal 2014. However, SG&A as a percentage of sales in fiscal 2015 was 13.7% of sales compared with 16.8% of sales in fiscal 2014.

We incurred a pre-tax restructuring charge of $1,718 ($1,164 after tax) for severance costs related largely to a voluntary early retirement program we offered in the fourth quarter of fiscal 2015 and to certain involuntary headcount reductions which occurred in the same quarter. Our reduction in headcount was approximately 10% of our global workforce. Approximately 20% of the headcount reductions occurred in the fourth quarter of fiscal 2015. The remaining headcount reductions occurred in the first four months of fiscal 2016. The expected annual savings from these reductions was approximately $3,000, of which $2,000 was realized in fiscal 2016.

Interest income for fiscal 2015 was $189, up from $94 in fiscal 2014. Interest expense for fiscal 2015 was $11 compared with $1 in fiscal 2014.

Our effective tax rate in fiscal 2015 was 32% compared with an effective tax rate of 31% for fiscal 2014.

Net income for fiscal 2015 and income per diluted share was $14,735 and $1.45, respectively.

Net income, excluding the impact of the restructuring charge, was $15,899 or $1.57 per diluted share, up 57% compared with $10,145 and $1.00, respectively, in fiscal 2014.

Stockholders’ Equity

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

March 31, 2016	March 31, 2015	March 31, 2014
$109,380	$116,551	$105,908

Fiscal 2016 Compared with Fiscal 2015

Stockholders’ equity decreased $7,171 or 6%, at March 31, 2016 compared with March 31, 2015. This decrease was primarily due to our repurchase of 539 shares at a cost of $9,441, partially offset by net income earned in fiscal 2016. See Item 5 of this Annual Report on Form 10-K for more information on our stock repurchase program.

On March 31, 2016, our net book value per share was $11.34, down 1% over March 31, 2015.

Fiscal 2015 Compared with Fiscal 2014

Stockholders' equity increased $10,643 or 10%, at March 31, 2015 compared with March 31, 2014. This increase was primarily due to our income earned in fiscal 2015.

On March 31, 2015, our net book value per share was $11.50, up 10% over March 31, 2014.

Liquidity and Capital Resources

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

	March 31,	
	2016	2015
Cash and investments	$65,072	$60,271
Working capital(1)	74,807	80,884
Working capital ratio(2)	3.7	3.7
Working capital excluding cash and investments	9,735	20,613

(1) Working capital equals current assets minus current liabilities.

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

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

Net cash generated by operating activities for fiscal 2016 was $18,751, compared with $6,279 for fiscal 2015. Cash generated from changes in unbilled revenues, customer deposits, and accounts receivables reversed cash usage in those categories in fiscal 2015. These were partially offset by lower net income, and decreases in accounts payable and accrued compensation.

Capital spending in fiscal 2016 was $1,153, compared with $5,300 in fiscal 2015. The fiscal 2015 capital spending included the capital expansion at our Batavia, NY manufacturing facility, which started in the middle of fiscal 2014 and was completed in the middle of fiscal 2015. This expansion was to support our growth strategies in the refining, petrochemical and for the U.S. Navy markets. Capital expenditures in fiscal 2016 were approximately 90% for facilities along with machinery and equipment and the remaining 10% for all other items.

Share repurchases of $9,441, to repurchase 539 shares, and dividend payments of $3,296 occurred in fiscal 2016. There were no share repurchases in fiscal 2015 and dividend payments were $2,026.

Cash and investments were $65,072 on March 31, 2016 compared with $60,271 on March 31, 2015, up $4,801 or 8%.

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 is held in the U.S. The remaining 5% is invested in our China operations.

Capital expenditures for fiscal 2017 are expected to be between approximately $2,000 and $2,500. Approximately 85% of our fiscal 2017 capital expenditures are expected to be for machinery and equipment, with the remaining amounts expected to be used for other items.

On December 2, 2015, we entered into a new senior revolving credit facility agreement with JP Morgan Chase Bank, N.A. This revolving credit facility replaced our previous facility, which was with Bank of America, N.A. The new facility is of equivalent size as the one it replaced, providing 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 March 31, 2016 and March 31, 2015 were $11,982 and $10,903, respectively. The outstanding letters of credit as of March 31, 2016 were issued by JP Morgan Chase, HSBC, as well as Bank of America, under our previous credit facility. JP Morgan letters of credit were $1,749 and HSBC letters of credit were $1,921 on March 31, 2016. Bank of America letters of credit were $8,312 on March 31, 2016 and were cash secured. The Bank of America letters of credit do not reduce the availability on our credit facility with JP Morgan Chase. The borrowing rate under our JP Morgan Chase facility as of March 31, 2016 was the bank’s prime rate, or 3.50%. Availability under the JP Morgan Chase and HSBC lines of credit was $26,330 at March 31, 2016. The availability under the Bank of America and HSBC lines, which were in place, on March 31, 2015, was $19,097. 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.

Contractual Obligations

As of March 31, 2016, our contractual and commercial obligations for the next five fiscal years ending March 31 and thereafter were as follows:

		Payments Due by Period			
	Total	Less Than 1 Year	1 – 3 Years	3 – 5 Years	Thereafter
Capital lease obligations[1]	$232	$64	$117	$51	$ —
Operating leases[1]	1,943	580	772	591	—
Pension and postretirement benefits[2]	88	88	—	—	—
Accrued compensation	74	74	—	—	—
Accrued pension liability	391	26	52	52	261
Total	$2,728	$832	$941	$694	$ 261

(1) For additional information, see Note 6 to the consolidated financial statements in Item 8 of Part II of this Annual Report on Form 10-K.

(2) Amounts represent anticipated contributions during fiscal 2016 to our postretirement medical benefit plan, which provides healthcare benefits for eligible retirees and eligible survivors of retirees. On February 4, 2003, we terminated postretirement healthcare benefits for our U.S. employees. Benefits payable to retirees of record on April 1, 2003 remained unchanged. We expect to be required to make cash contributions in connection with these plans beyond one year, but such amounts cannot be estimated. No contributions are expected to be made to our defined benefit pension plan for fiscal 2017.

Orders and Backlog

Orders in fiscal 2016 decreased 38% to $83,997 from $136,533 in fiscal 2015, net of $12,095 of cancellations which occurred in fiscal 2016. Orders represent communications received from customers requesting us to supply products and services. Revenue is recognized on orders received in accordance with our revenue recognition policy described in Note 1 to the consolidated financial statements contained in Item 8 of Part II of this Annual Report on Form 10-K.

Domestic orders were 67%, or $56,383, and international orders were 33%, or $27,614, of our total orders in fiscal 2016. This compared to domestic orders of $92,115, or 67%, of total orders, and international orders of $44,418, or 33%, of our total orders in fiscal 2015. Domestic orders decreased by $35,732, or 39%. In fiscal 2015 there was a large U.S. Navy order, which did not repeat in fiscal 2016. In addition, there was lower demand in the refining and petrochemical processing industries, partly offset by increased power orders. International orders decreased by $16,804, or 38%, due to decreases in orders from and cancellations from Canada.

Backlog was $107,963 at March 31, 2016, down 5% compared with $113,811 at March 31, 2015. Backlog is defined by us as the total dollar value of orders received for which revenue has not yet been recognized. All orders in backlog represent orders from our traditional markets in established product lines. Approximately 45% to 55% of orders currently in our backlog are expected to be converted to sales within one year. At March 31, 2016, approximately 21% of our backlog was attributed to equipment for refinery project work, 11% for chemical and petrochemical projects, 17% for power, including nuclear energy, 47% for U.S. Navy projects and 4% for other industrial or commercial applications. At March 31, 2015, approximately 24% of our backlog was for refinery project work, 15% for chemical and petrochemical projects, 9% for power, including nuclear energy, 48% for U.S. Navy projects and 4% for other industrial or commercial applications. At March 31, 2016, we had two projects for $6,466 on hold. We had three projects totaling $12,095 cancelled in fiscal 2016. In fiscal 2015, we had two projects for $5,895 cancelled.

Strategy and Outlook

Continued weakness in the global energy markets is expected to impact our business in fiscal 2017. The decrease in orders, and multiple cancellations, which occurred in fiscal 2016 I expected to lead to a challenging fiscal 2017. Our pipeline has contracted as our oil refining and chemical market customers further reduced their capital spending plans when compared with last year in reaction to low and volatile oil prices. The expected duration of this downturn is uncertain. We expect to see strength in our power business as our power orders in fiscal 2016 improved compared with fiscal 2015.

Despite the current downturn, we continue to believe in the long-term strength of the energy markets. Coupled with our diversification strategy with the U.S. Navy and the power market, we believe this long-term strength will support our strategy to significantly grow our business when the energy markets recover. 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.

The headwinds in the energy markets have caused near term uncertainty. This has affected our outlook for fiscal 2017. We expect revenue in fiscal 2017 to be approximately $80,000 to $95,000. We project that approximately 45% to 55% of our March 31, 2016 backlog will convert to sales in fiscal 2017. We expect the remaining backlog will convert beyond fiscal 2017, 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 the conversion of which has been extended by our customers.

We expect gross profit margin in fiscal 2017 to be in the 24% to 26% range, compared with 25.8% in fiscal 2016. We expect continued pricing pressure and under-utilization of our production facilities in fiscal 2017. We believe that production overhead absorption will be weak, which we expect in turn will put pressure on gross profit margins.

SG&A spending during fiscal 2017 is expected to be between $17,500 and $18,500, or approximately 19% and 20% of sales. Our effective tax rate during fiscal 2017 is expected to be between 32% and 33%.

We expect that cash flow in fiscal 2017 will be much more moderate than fiscal 2016. Fiscal 2016 cash flow benefited from the build-up of accounts receivable and unbilled revenue which occurred in the latter portion of fiscal 2015 and was converted to cash in fiscal 2016.

We continue to believe that the long-term outlook for the energy markets is strong. We will continue to look toward future growth while being mindful of near term profitability, given short-term challenges.

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 are similar to previous asbestos lawsuits that named us as a defendant. Such previous lawsuits either were dismissed when it was shown that we had not supplied products to the plaintiffs' places of work or were settled by us for immaterial amounts.

As of March 31, 2016, 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 to which we are, or may become, a party to 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

The discussion and analysis of our financial condition and results of operations are based upon the consolidated financial statements and the notes to consolidated financial statements included in Item 8 of Part II of this Annual Report on Form 10-K, which have been prepared in accordance with accounting principles generally accepted in the U.S.

Critical accounting policies are defined as those that reflect significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions.

Revenue Recognition. We recognize revenue on all contracts with a planned manufacturing process in excess of four weeks (which approximates 575 direct labor hours) using the percentage-of-completion method. The majority of our revenue is recognized under this methodology. The percentage-of-completion method is determined by comparing actual labor incurred as of a specific date to our estimate of the total labor to be incurred on each contract or completion of operational milestones assigned to each contract. Contracts in progress are reviewed monthly, and sales and earnings are adjusted in current accounting periods based on revisions in the contract value and estimated material and labor costs at completion. Losses on contracts are recognized immediately, when evident to management.

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

Valuation of Goodwill and Intangible Assets. Assets and liabilities acquired in a business combination are recorded at their estimated fair values at the acquisition date. The fair value of identifiable intangible assets is based upon detailed valuations that use various assumptions made by management. Goodwill is recorded when the purchase price exceeds the estimated fair value of the net identifiable tangible and intangible assets acquired. Definite lived intangible assets are amortized over their estimated useful lives and are assessed for impairment if certain indicators are present. Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to impairment testing annually or earlier if an event or change in circumstances indicates that the fair value of a reporting unit may have been reduced below its carrying value.

Pension and Postretirement Benefits. Defined benefit pension and other postretirement benefit costs and obligations are dependent on actuarial assumptions used in calculating such amounts. These assumptions are reviewed annually and include the discount rate, long-term expected rate of return on plan assets, salary growth, healthcare cost trend rate and other economic and demographic factors. We base the discount rate assumption for our plans on Moody's or Citigroup Pension Liability Index AA-rated corporate long-term bond yield rate. The long-term expected rate of return on plan assets is based on the plan's asset allocation, historical returns and expectations as to future returns that are expected to be realized over the estimated remaining life of the plan liabilities that will be funded with the plan assets. The salary growth assumptions are determined based on long-term actual experience and future and near-term outlook. The healthcare cost trend rate assumptions are based on historical cost and payment data, the near-term outlook, and an assessment of likely long-term trends.

Income Taxes. We use the liability method to account for income taxes. Under this method, deferred tax liabilities and assets are recognized for the tax effects of temporary differences between the financial reporting and tax bases of liabilities and assets measured using the enacted tax rate.

Deferred income tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using current tax rates. We evaluate available information about future taxable income and other possible sources of realization of deferred income tax assets and record valuation allowances to reduce deferred income tax assets to an amount that represents our best estimates of the amounts of such deferred income tax assets that more likely than not will be realized.

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We establish reserves for uncertain tax positions when we believe that certain tax positions do not meet the more likely than not threshold. We adjust these reserves in light of changing facts and circumstances, such as the outcome of a tax audit or the lapse of the statute of limitations. The provision for income taxes includes the impact of reserve provisions and changes to the reserves that are considered appropriate.

Critical Accounting Estimates and Judgments

We have evaluated the accounting policies used in the preparation of the consolidated financial statements and the notes to consolidated financial statements included in Item 8 of Part II of this Annual Report on Form 10-K and believe those policies to be reasonable and appropriate.

We believe that the most critical accounting estimates used in the preparation of our 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 goodwill and 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.

As discussed above under the heading "Critical Accounting Policies," we recognize a majority of our revenue using the percentage-of-completion method. The key estimate of percentage-of-completion accounting is total labor to be incurred on each contract and to the extent that this estimate changes, it may significantly impact revenue recognized in each period.

We base the fair value of identifiable tangible and intangible assets on detailed valuations that use information and assumptions provided by management. The fair values of the assets acquired and liabilities assumed are determined using one of three valuation approaches: market, income or cost. The selection of a particular method for a given asset depends on the reliability of available data and the nature of the asset. The market approach values the asset based on available market pricing for comparable assets. The income approach values the asset based on the present value of cash flows projected to be generated by that asset. The projected cash flows are discounted at a required rate of return that reflects the relative risk of the transaction and the time value of money. The projected cash flows for each asset considers multiple factors, including current revenue from existing customers, the high cost barrier to entry of markets, and expected profit margins giving consideration to historical and expected margins. The cost approach values the asset by determining the current cost of replacing that asset with another of equivalent economic utility. The cost to replace the asset reflects the replacement cost, less an allowance for loss in value due to depreciation or obsolescence, with specific consideration given to economic obsolescence if indicated.

Contingencies, by their nature, relate to uncertainties that require us to exercise judgment both in assessing the likelihood that a liability has been incurred as well as in estimating the amount of potential loss. For more information on these matters see the notes to consolidated financial statements included in Item 8 of Part II of this Annual Report on Form 10-K.

Accounting for pensions and other postretirement benefits involves estimating the cost of benefits to be provided well into the future and attributing that cost over the time period each employee works. To accomplish this, extensive use is made of assumptions about inflation, investment returns, mortality, turnover, medical costs and discount rates. These assumptions are reviewed annually.

The discount rate used in accounting for pensions and other postretirement benefits expense (income) is determined in conjunction with our actuary by reference to a current yield curve and by considering the timing and amount of projected future benefit payments. The discount rate assumption for fiscal 2016 was 3.74% for our defined benefit pension plan and 3.11% for our other postretirement benefit plan. A reduction in the discount rate of 50 basis points, with all other assumptions held constant, would have increased fiscal 2016 net periodic benefit expense for our defined benefit pension plan and other postretirement benefit plan by approximately $840 and $0, respectively.

The expected return on plan assets assumption of 8.0% used in accounting for our pension plan is determined by evaluating the mix of investments that comprise plan assets and external forecasts of future long-term investment returns. A reduction in the rate of return of 50 basis points, with other assumptions held constant, would have increased fiscal 2016 net periodic pension expense by approximately $199.

During fiscal 2016, the pension plan released liabilities for vested benefits of certain participants through the purchase of nonparticipating annuity contracts with a third party insurance company. As a result of this transaction, the projected benefit obligation and plan assets decreased $1,710 and $1,798, respectively.

As part of our ongoing financial reporting process, a collaborative effort is undertaken involving our managers with functional responsibilities for financial, credit, tax, engineering, manufacturing and benefit matters, and outside advisors such as lawyers, consultants and actuaries. We believe that the results of this effort provide management with the necessary information on which to base their judgments and to develop the estimates and assumptions used to prepare the financial statements.

We believe that the amounts recorded in the consolidated financial statements included in Item 8 of Part II of this Annual Report on Form 10-K related to revenue, contingencies, pensions, other postretirement benefits and other matters requiring the use of estimates and judgments are reasonable, although actual outcomes could differ materially from our estimates.

New Accounting Pronouncements

In the normal course of business, management evaluates all new accounting pronouncements issued by the Financial Accounting Standards Board, the SEC, the Emerging Issues Task Force, the American Institute of Certified Public Accountants or any other authoritative accounting body to determine the potential impact they may have on our consolidated financial statements. For discussion of the newly issued accounting pronouncements see “Accounting and reporting changes” in Note 1 to the Consolidated Financial Statements included in Item 8 of Part II of this Annual Report on Form 10-K.

Off Balance Sheet Arrangements

We did not have any off balance sheet arrangements as of March 31, 2016 or March 31, 2015, other than operating leases and letters of credit incurred in the ordinary course of business.

Item 7A. 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 fiscal 2016 were 37% of total sales, down from 36% of sales in fiscal 2015. 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 each of fiscal 2016, fiscal 2015, and fiscal 2014, substantially all sales for which we or our subsidiaries were paid were denominated in the local currency (U.S. dollars or Chinese RMB).

We have limited exposure to foreign currency purchases. In each of fiscal 2016, fiscal 2015 and fiscal 2014, our purchases in foreign currencies represented 1% of the 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 fiscal 2016 or fiscal 2015, and as of March 31, 2016 and 2015, respectively, 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. In extreme market downturns, such as we are currently experiencing, we typically see depressed price levels. Moreover, the cost of metals and other materials used in our products have experienced significant volatility. Such factors, in addition to the global effects of the recent volatility and disruption of the capital and credit markets, have resulted in downward demand and pricing pressure on our products.

Project Cancellation and Project Continuation Risk

Adverse economic or specific project conditions can lead to a project being placed on hold or cancelled by our customers. In fiscal 2016, we had three projects totaling $12,095, which were cancelled. In fiscal 2015, we had two projects totaling $5,895 cancelled. At March 31, 2016, we had two projects for $6,466 on hold. 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.

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.

Item 8. Financial Statements and Supplementary Data

INDEX TO FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended March 31,		
	2016	2015	2014
	(Amounts in thousands, except per share data)		
Net sales	$90,039	$135,169	$102,218
Cost of products sold	66,784	93,365	70,406
Gross profit	23,255	41,804	31,812
Other expenses and income:			
Selling, general and administrative	16,331	18,283	16,973
Selling, general and administrative - amortization	234	229	222
Restructuring charge	—	1,718	—
Other income	(1,789)	—	—
Interest income	(261)	(189)	(94)
Interest expense	10	11	1
Total other expenses and income	14,525	20,052	17,102
Income before provision for income taxes	8,730	21,752	14,710
Provision for income taxes	2,599	7,017	4,565
Net income	$6,131	$14,735	$10,145
Per share data			
Basic:			
Net income	$0.61	$1.46	$1.01
Diluted:			
Net income	$0.61	$1.45	$1.00
Average common shares outstanding:			
Basic	9,976	10,123	10,070
Diluted	9,983	10,143	10,104
Dividends declared per share	$.33	$.20	$.13

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended March 31,		
	2016	2015	2014
	(Amounts in thousands)		
Net income	$6,131	$14,735	$10,145
Other comprehensive income:			
Foreign currency translation adjustment	(150)	3	(7)
Defined benefit pension and other postretirement plans, net of income tax (benefit) provision, of $(804), $(1,802), and $1,244 for the years ended March 31, 2016, 2015 and 2014, respectively	(1,470)	(3,294)	2,275
Total other comprehensive income	(1,620)	(3,291)	2,268
Total comprehensive income	$4,511	$11,444	$12,413

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

	March 31, 2016	2015
	(Amounts in thousands, except per share data)	
Assets		
Current assets:		
Cash and cash equivalents	$24,072	$27,271
Investments	41,000	33,000
Trade accounts receivable, net of allowances ($91 and $62 at March 31, 2016 and 2015, respectively)	12,730	17,249
Unbilled revenue	11,852	18,665
Inventories	10,811	13,994
Prepaid expenses and other current assets	613	529
Income taxes receivable	1,652	339
Total current assets	102,730	111,047
Property, plant and equipment, net	18,747	19,812
Prepaid pension asset	—	1,332
Goodwill	6,938	6,938
Permits	10,300	10,300
Other intangible assets, net	4,248	4,428
Other assets	168	146
Total assets	$143,131	$154,003
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of capital lease obligations	$55	$60
Accounts payable	10,325	13,334
Accrued compensation	5,317	9,343
Accrued expenses and other current liabilities	3,826	3,247
Customer deposits	8,400	4,179
Total current liabilities	27,923	30,163
Capital lease obligations	157	98
Accrued compensation	—	124
Deferred income tax liability	3,546	5,876
Accrued pension liability	1,338	315
Accrued postretirement benefits	787	876
Total liabilities	33,751	37,452
Commitments and contingencies (Notes 6 and 17)		
Stockholders' equity:		
Preferred stock, $1.00 par value, 500 shares authorized		
Common stock, $.10 par value, 25,500 shares authorized 10,468 and 10,433 shares issued and 9,646 and 10,133 shares outstanding at March 31, 2016 and 2015, respectively	1,047	1,043
Capital in excess of par value	22,315	21,398
Retained earnings	109,013	106,178
Accumulated other comprehensive loss	(10,676)	(9,056)

Treasury stock (822 and 299 shares)	(12,319)	(3,012)
Total stockholders' equity	109,380	116,551
Total liabilities and stockholders' equity	$ 143,131	$ 154,003

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended March 31, 2016	2015	2014
	(Dollar amounts in thousands)		
Operating activities:			
Net income	$6,131	$14,735	$10,145
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	2,201	2,079	1,977
Amortization	234	229	222
Amortization of unrecognized prior service cost and actuarial losses	1,214	514	886
Discount accretion on investments	—	—	(8)
Stock-based compensation expense	697	653	639
Loss on disposal or sale of property, plant and equipment	4	14	223
Deferred income taxes	(1,522)	157	(1,011)
(Increase) decrease in operating assets:			
Accounts receivable	4,440	(6,910)	(1,001)
Unbilled revenue	6,783	(10,835)	5,318
Inventories	3,175	2,525	(5,161)
Income taxes receivable/payable	(1,309)	158	2,137
Prepaid expenses and other current and non-current assets	(162)	(152)	185
Prepaid pension asset	(1,222)	(1,108)	(793)
Increase (decrease) in operating liabilities:			
Accounts payable	(2,836)	3,115	595
Accrued compensation, accrued expenses and other current and non-current liabilities	(3,178)	4,981	28
Customer deposits	4,227	(3,834)	1,009
Long-term portion of accrued compensation, accrued pension liability and accrued postretirement benefits	(126)	(42)	(160)
Net cash provided by operating activities	18,751	6,279	15,230
Investing activities:			
Purchase of property, plant and equipment	(1,153)	(5,300)	(5,263)
Proceeds from disposal of property, plant and equipment	3	1	32
Purchase of investments	(44,000)	(50,000)	(109,494)
Redemption of investments at maturity	36,000	46,000	108,000
Net cash used by investing activities	(9,150)	(9,299)	(6,725)
Financing activities:			
Principal repayments on capital lease obligations	(59)	(80)	(88)
Issuance of common stock	97	47	581
Dividends paid	(3,296)	(2,026)	(1,308)
Purchase of treasury stock	(9,441)	—	—
Excess tax deduction on stock awards	6	200	271
Net cash used by financing activities	(12,693)	(1,859)	(544)
Effect of exchange rate changes on cash	(107)	4	(9)
Net (decrease) increase in cash and cash equivalents	(3,199)	(4,875)	7,952

Cash and cash equivalents at beginning of year	27,271	32,146	24,194
Cash and cash equivalents at end of year	$24,072	$27,271	$32,146

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended March 31, 2016, 2015 and 2014

(Dollar and share amounts in thousands)

	Common Stock Shares	Common Stock Par Value	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Stockholders' Equity
Balance at April 1, 2013	10,331	$1,033	$18,596	$84,632	$ (8,033)	$(3,233)	$ 92,995
Comprehensive income				10,145	2,268		12,413
Issuance of shares	78	8	573				581
Stock award tax benefit			271				271
Dividends				(1,308)			(1,308)
Recognition of equity-based compensation expense			639				639
Issuance of treasury stock			195			122	317
Balance at March 31, 2014	10,409	1,041	20,274	93,469	(5,765)	(3,111)	105,908
Comprehensive income							