ESPEY MFG & ELECTRONICS CORP
Form 10-Q
May 10, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

S QUARTERLY Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2012

OR

£ Transition Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 for the transition period from _______ to _______

Commission File Number I-4383

ESPEY MFG. & ELECTRONICS CORP.

(Exact name of registrant as specified in its charter)

NEW YORK 14-1387171
(State of incorporation) (I.R.S. Employer's Identification No.)

233 Ballston Avenue, Saratoga Springs, New York 12866

(Address of principal executive offices)

Registrant's telephone number, including area code 518-584-4100

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

S Yes £ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

S Yes £ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company:

£ Large accelerated filer

£ Accelerated filer

£ Non-accelerated filer

S Smaller reporting company

Indicate by check mark whether the registrant is a shell company.

£ Yes S No

At May 10, 2012, there were 2,320,822 shares outstanding of the registrant's Common stock, $.33-1/3 par value.

ESPEY MFG. & ELECTRONICS CORP.

Quarterly Report on Form 10-Q

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PART I: FINANCIAL INFORMATION

ESPEY MFG. & ELECTRONICS CORP.

Balance Sheets

March 31, 2012 (Unaudited) and June 30, 2011

	March 31, 2012	June 30, 2011
ASSETS:		
Cash and cash equivalents	$9,870,589	$9,695,811
Investment securities	3,488,847	1,946,214
Trade accounts receivable, net	3,469,608	6,266,765
Inventories:		
Raw materials	1,444,204	1,273,582
Work-in-process	792,954	1,085,278
Costs relating to contracts in process, net of advance payments of $231,666 at March 31, 2012 and $126,361 at June 30, 2011	9,191,851	8,220,200
Total inventories	11,429,009	10,579,060
Deferred income taxes	390,882	360,553
Prepaid expenses and other current assets	222,907	208,904
Total current assets	28,871,842	29,057,307
Property, plant and equipment, net	2,590,832	2,703,014
Loan receivable	77,719	108,303
Total assets	$31,540,393	$31,868,624

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.

Balance Sheets

March 31, 2012 (Unaudited) and June 30, 2011

	March 31, 2012	June 30, 2011
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Accounts payable	$1,482,776	$1,453,707
Accrued expenses:		
Salaries, wages and commissions	305,387	412,555
Vacation	676,165	623,757
ESOP payable	112,439	—
Other	137,724	121,026
Payroll and other taxes withheld and accrued	45,528	44,085
Income taxes payable	176,272	277,746
Total current liabilities	2,936,291	2,932,876
Deferred income taxes	216,831	270,729
Total liabilities	3,153,122	3,203,605
Common stock, par value $.33-1/3 per share. Authorized 10,000,000 shares; issued 3,029,874 shares on March 31, 2012 and June 30, 2011. Outstanding 2,320,822 and 2,320,960 (includes 141,875 and 157,500 Unearned ESOP Shares on March 31, 2012 and June 30, 2011, respectively)	1,009,958	1,009,958
Capital in excess of par value	14,856,933	14,674,189
Accumulated other comprehensive income/loss	1,813	—
Retained earnings	22,410,871	22,780,026
	38,279,575	38,464,173
Less: Unearned ESOP shares	(2,275,872)	(2,275,872)
Treasury shares, cost of 709,052 shares on March 31, 2012 and 708,914 shares on June 30, 2011	(7,616,432)	(7,523,282)
Total stockholders’ equity	28,387,271	28,665,019
Total liabilities and stockholders' equity	$31,540,393	$31,868,624

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.

Statements of Income (Unaudited)

Three and Nine Months Ended March 31, 2012 and 2011

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2012	2011	2012	2011
Net sales	$7,661,946	$7,005,795	$23,921,627	$19,613,467
Cost of sales	5,257,556	4,958,639	17,333,569	14,290,980
Gross profit	2,404,390	2,047,156	6,588,058	5,322,487
Selling, general and administrative expenses	663,625	663,544	2,097,317	2,100,027
Operating income	1,740,765	1,383,612	4,490,741	3,222,460
Other income (expense)				
Interest and dividend income	13,926	13,616	37,396	43,925
Other	7,492	13,048	23,594	97,734
	21,418	26,664	60,990	141,659
Income before income taxes	1,762,183	1,410,276	4,551,731	3,364,119
Provision for income taxes	499,320	398,245	1,291,101	948,802
Net income	$1,262,863	$1,012,031	$3,260,630	$2,415,317
Net income per share:				
Basic	$.58	$.47	$1.50	$1.12
Diluted	$.58	$.46	$1.48	$1.11
Weighted average number of shares outstanding:				
Basic	2,174,640	2,157,427	2,170,466	2,150,330
Diluted	2,196,366	2,181,559	2,197,677	2,173,518
Dividends per share:	$.2250	$.2250	$1.6750	$1.6750

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.

Statements of Cash Flows (Unaudited)

Nine Months Ended March 31, 2012 and 2011

	March 31, 2012	2011
Cash Flows From Operating Activities:		
Net income	$3,260,630	$2,415,317
Adjustments to reconcile net income to net cash provided by operating activities:		
Excess tax benefits from share-based compensation	(40,801)	(10,939)
Stock-based compensation	68,499	54,374
Depreciation	321,144	349,723
ESOP compensation expense	376,251	361,941
Loss on disposal of assets	21,297	15
Deferred income tax	(84,227)	27,751
Changes in assets and liabilities:		
Decrease in trade receivables, net	2,797,157	1,768,073
Increase in inventories	(849,949)	(434,354)
(Increase) decrease in prepaid expenses and other current assets	(14,003)	6,525
Increase (decrease) in accounts payable	29,069	(565,307)
(Decrease) increase in accrued salaries, wages and commissions	(107,168)	74,159
Increase in vacation accrual	52,408	23,082
Decrease in ESOP payable	(263,812)	(300,104)
Increase (decrease) in other accrued expenses	16,698	(75,445)
Increase (decrease) in payroll & other taxes withheld and accrued	1,443	(2,613)
(Decrease) increase in income taxes payable	(60,673)	115,052
Net cash provided by operating activities	5,523,963	3,807,250
Cash Flows From Investing Activities:		
Additions to property, plant & equipment	(230,259)	(590,503)
Payment for loan receivable	—	(125,000)
Proceeds from loan receivable	30,584	18,200
Purchase of investment securities	(3,663,325)	(2,690,000)
Maturity of investment securities	2,122,505	6,960,000
Net cash (used in) provided by investing activities	(1,740,495)	3,572,697
Cash Flows From Financing Activities:		
Sale of treasury stock	58,975	12,081
Dividends on common stock	(3,629,785)	(3,598,589)
Purchase of treasury stock	(143,731)	(575,246)
Proceeds from exercise of stock options	65,050	267,436
Excess tax benefits from share-based compensation	40,801	10,939
Net cash used in financing activities	(3,608,690)	(3,883,379)
Increase in cash and cash equivalents	174,778	3,496,568
Cash and cash equivalents, beginning of period	9,695,811	4,475,066
Cash and cash equivalents, end of period	9,870,589	7,971,634

Supplemental Schedule of Cash Flow Information:		
Income taxes paid	$1,436,000	$806,000

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.

Notes to Financial Statements (Unaudited)

Note 1. Basis of Presentation

In the opinion of management the accompanying unaudited financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the results for such periods. The results for any interim period are not necessarily indicative of the results to be expected for the full fiscal year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles have been condensed or omitted. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of assets and liabilities. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, inventories, income taxes, and stock-based compensation. Management bases its estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. These financial statements should be read in conjunction with the Company's most recent audited financial statements included in its report on Form 10-K for the year ended June 30, 2011. Certain reclassifications may have been made to the prior year financial statements to conform to the current year presentation.

Note 2. Net Income per Share

Basic net income per share excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the income of the Company. As Unearned ESOP shares are released or committed-to-be-released the shares become outstanding for net income-per-share computations.

Note 3. Stock Based Compensation

The Company follows ASC 718 in establishing standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services, as well as transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity’s equity instruments or that may be settled by the issuance of those equity instruments. ASC 718 requires that the cost resulting from all share-based payment transactions be recognized in the financial statements based on the fair value of the share-based payment. ASC 718

establishes fair value as the measurement objective in accounting for share-based payment transactions with employees, except for equity instruments held by employee share ownership plans.

Total stock-based compensation expense recognized in the Statement of Income for the three month period ended March 31, 2012 and 2011, was $26,074 and $16,735, respectively, before income taxes. The related total deferred tax benefit was approximately $2,726 and $1,427 for the three month period ended March 31, 2012 and 2011, respectively. Total stock-based compensation expense recognized in the Statement of Income for the nine month period ended March 31, 2012 and 2011, was $68,499 and $54,374, respectively, before income taxes. The related total deferred tax benefit was approximately $7,036 and $4,589 for the nine month period ended March 31, 2012 and 2011, respectively. ASC 718 requires the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options to be classified and reported as both an operating cash outflow and a financing cash inflow on a prospective basis upon adoption.

As of March 31, 2012, there was approximately $101,426 of unrecognized compensation cost related to stock option awards that is expected to be recognized as expense over the next 1.5 years. The total deferred tax benefit related to these awards is approximately $11,228.

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The Company has one employee stock option plan under which options may be granted, the 2007 Stock Option and Restricted Stock Plan (the "2007 Plan"). The Board of Directors may grant options to acquire shares of common stock to employees of the Company at the fair market value of the common stock on the date of grant. Generally, options granted have a two-year vesting period based on two years of continuous service and have a ten-year contractual life. Option grants provide for accelerated vesting if there is a change in control. Shares issued upon the exercise of options are from those held in Treasury. The 2007 Plan was approved by the Company's shareholders at the Company's Annual Meeting on November 30, 2007 and supersedes the Company's 2000 Stock Option Plan (the "2000 Plan"). Options covering 400,000 shares were authorized for issuance under the 2007 Plan, of which 128,900 have been granted and 104,250 are outstanding as of March 31, 2012. While no further grants of options may be made under the 2000 Plan, as of March 31, 2012, 53,200 options remain outstanding, vested and exercisable from the 2000 Plan.

ASC 718 requires the use of a valuation model to calculate the fair value of stock-based awards. The Company has elected to use the Black-Scholes option valuation model, which incorporates various assumptions including those for volatility, expected life and interest rates.

The table below outlines the weighted average assumptions that the Company used to calculate the fair value of each option award for the nine months ended:

	2012	2011
Dividend yield	3.59%	4.69%
Expected stock price volatility	33.82%	33.13%
Risk-free interest rate	0.64%	1.08%
Expected option life (in years)	3.7yrs	4.1yrs
Weighted average fair value per share of options granted during the period	$4.757	$3.335

The Company pays dividends quarterly and anticipates that it will be able to continue to pay dividends in the foreseeable future. While the Company has paid a special cash dividend of $1.00 per share in each of fiscal years 2012 and 2011, there is no assurance that the Board of Directors will declare a comparable special dividend in fiscal year 2013. Expected stock price volatility is based on the historical volatility of the Company’s stock. The risk-free interest rate is based on the implied yield available on U.S. Treasury issues with an equivalent term approximating the expected life of the options. The expected option life (in years) represents the estimated period of time until exercise and is based on actual historical experience.

The following table summarizes stock option activity during the nine months ended March 31, 2012:

	Employee Stock Options Plan			
			Weighted	
	Number of	Weighted	Average	
	Shares	Average	Remaining	Aggregate

	Subject To Option	Exercise Price	Contractual Term	Intrinsic Value
Balance at July 1, 2011	132,400	$ 18.62	6.80	
Granted	29,100	$ 25.10	9.40	
Exercised	(3,800)	$ 17.12	—	
Forfeited or expired	(250)	$ 25.10	—	
Outstanding at March 31, 2012	157,450	$ 19.84	6.65	$ 783,081
Vested or expected to vest at March 31, 2012	149,203	$ 19.72	6.53	$ 758,992
Exercisable at March 31, 2012	98,800	$ 18.49	5.30	$ 613,251

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the closing sale price of the company’s common stock as reported on the NYSE-Amex on March 31, 2012 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders if all option holders had exercised their options on March 31, 2012. This amount changes based on the fair market value of the company’s common stock. The total intrinsic values of the options exercised during the nine months ended March 31, 2012 and 2011 was $21,089 and $66,929, respectively.

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Note 4. Commitments and Contingencies

The Company at certain times enters into standby letters of credit agreements with financial institutions primarily relating to the guarantee of future performance on certain contracts. Contingent liabilities on outstanding standby letters of credit agreements aggregated to zero at March 31, 2012 and 2011. The Company, as a U.S. Government contractor, is subject to audits, reviews, and investigations by the U.S. government related to its negotiation and performance of government contracts and its accounting for such contracts. Failure to comply with applicable U.S. Government standards by a contractor may result in suspension from eligibility for award of any new government contract and a guilty plea or conviction may result in debarment from eligibility for awards. The government may, in certain cases, also terminate existing contracts, recover damages, and impose other sanctions and penalties. As a result of a pending U.S. government audit the Company has determined a range of possible outcomes none of which the Company believes would have a materially adverse effect on the Company's financial position or results of operations. In accordance with ASC 450 “Contingencies” the Company has accrued the amount within the range that appears to be its best estimate of a possible outcome.

Note 5. Recently Issued Accounting Standards

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, topic 820, “Fair Value Measurement,” to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with United States GAAP and International Financial Reporting Standards. Some of the amendments clarify the Board’s intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. Specifically, the guidance requires additional disclosures for fair value measurements that are based on significant unobservable inputs. The updated guidance was to be applied prospectively and is effective for the Company’s interim and annual periods beginning January 1, 2012. The adoption of this guidance did not have a material impact on the Company’s consolidated financial statements.

FASB Accounting Standards Update 2011-05, "Presentation of Comprehensive Income," was issued in June 2011 to be effective for fiscal years beginning after December 15, 2011. Comprehensive income includes certain items that are recognized as "other comprehensive income" ("OCI") and are excluded from net income. Examples include unrealized gains/losses on certain investments and gains/losses on derivative instruments designated as hedges. Under provisions of the update, the components of OCI must be presented in one of two formats: either (i) together with net income in a continuous statement of comprehensive income or (ii) in a second statement of comprehensive income to immediately follow the income statement. An existing option to present the components of OCI as part of the statement of changes in shareholders' equity is being eliminated. The Company expects the update to have minimal effect on its financial statements. The FASB recently issued Accounting Standards Update (ASU 2011-12) that defers the effective date of the requirement to present separate line items on the income statement for reclassification adjustments of items out of accumulated other comprehensive income into net income. The deferral is temporary until the Board reconsiders the operational concerns and needs of financial statement users. The Board has not yet established a timetable for its

reconsideration.

Note 6. Employee Stock Ownership Plan

The Company sponsors a leveraged employee stock ownership plan (the "ESOP") that covers all nonunion employees who work 1,000 or more hours per year and are employed on June 30. The Company makes annual contributions to the ESOP equal to the ESOP's debt service less dividends on unallocated shares received by the ESOP. All dividends on unallocated shares received by the ESOP are used to pay debt service. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings. As the debt is repaid, shares are released and allocated to active employees, based on the proportion of debt service paid in the year. The Company accounts for its ESOP in accordance with FASB ASC 718-40. Accordingly, the shares purchased by the ESOP are reported as Unearned ESOP Shares in the statement of financial position. As shares are released or committed-to-be-released, the Company reports compensation expense equal to the current average market price of the shares, and the shares become outstanding for earnings-per-share (EPS) computations. ESOP compensation expense was $124,896 and $126,533 for the three month periods ended March 31, 2012 and 2011, respectively. ESOP compensation expense was $376,251 and $361,941 for the nine month periods ended March 31, 2012 and 2011, respectively. The ESOP shares as of March 31, 2012 and 2011 were as follows:

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	March 31, 2012	March 31, 2011
Allocated Shares	433,754	422,273
Committed-to-be-released shares	15,625	16,250
Unreleased shares	141,875	162,916
Total shares held by the ESOP	591,254	601,439
Fair value of unreleased shares	$3,511,406	$4,066,383

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

Overview

Espey Mfg. & Electronics Corp. (the “Company”) is a power electronics design and original equipment manufacturing (OEM) company with a long history of developing and delivering highly reliable products for use in military and severe environment applications. All design, manufacturing, and testing is performed in our 150,000+ square foot facility located at 233 Ballston Ave, Saratoga Springs, New York. Espey is classified as a “smaller reporting company” for purposes of the reporting requirements under the Securities Exchange Act of 1934, as amended. Espey’s common stock is publicly-traded on the NYSE-Amex under the symbol “ESP.”

Espey began operations after incorporation in New York in 1928. We strive to remain competitive as a leader in high power energy conversion and transformer solutions through the design and manufacture of new and improved products by using advanced and “cutting edge” electronics technologies.

Espey is ISO 9001:2008 certified and our primary products are power supplies, power converters, filters, power transformers, magnetic components, power distribution equipment, ups systems, antennas and high power radar systems. The applications of these products include AC and DC locomotives, shipboard power, shipboard radar, airborne power, ground-based radar, and ground mobile power.

Espey services include design and development to specification, build to print, design services, design studies, environmental testing services, metal fabrication, painting services, and development of automatic testing equipment. Espey is vertically integrated, meaning that the Company produces individual components (including inductors), populates printed circuit boards, fabricates metalwork, paints, wires, qualifies, and fully tests items, mechanically, electrically and environmentally, in house. Portions of the manufacturing process are subcontracted to vendors from time to time.

Business is solicited from large industrial manufacturers and defense companies, the government of the United States, foreign governments and major foreign electronic equipment companies. In certain countries the Company has external sales representatives to help solicit and coordinate foreign contracts. The Company is also on the eligible list of contractors of agencies of the United States Department of Defense and generally is automatically solicited by such agencies for procurement needs falling within the major classes of products produced by the Company. In addition, the Company directly solicits bids from the United States Department of Defense for prime contracts. Espey contracts with the Federal Government under cage code 20950 as Espey Mfg. & Electronics Corp. and cage code 98675 as Espey Mfg. & Electronics Corp., Saratoga Industries Division.

There is competition in all classes of products manufactured by the Company from divisions of the largest electronic companies, as well as many small companies. The Company's sales do not represent a significant share of the industry's market for any class of its products. The principal methods of competition for electronic products of both a military and industrial nature include, among other factors, price, product performance, the experience of the particular company and history of its dealings in such products. The Company, as well as other companies engaged in supplying equipment for military use, is subject to various risks, including, without limitation, dependence on United States and foreign government appropriations and program allocations, the competition for available military business, and government termination of orders for convenience.

New orders received in the first nine months of fiscal 2012 were approximately $22.2 million, which was 26% less than the amount of new orders received in the first nine months of fiscal 2011. Due to the uncertain timing of receipt of new orders, particularly large orders, period to period comparisons are not necessarily indicative of business trends.

The new orders were predominantly in line with our strategy of getting involved in products incidental to long-term, high quantity military and industrial products and represented follow-on production of mature products. We are able to be more price-competitive in responding to repeat orders for long-term projects because our early stage design costs have already been absorbed. Conversely, we believe that a principal impediment to our receipt of awards of products in connection with new programs has been our pricing reflecting the inclusion of up-front design costs. Accordingly, we are in the process of re-examining our pricing strategy in order to achieve a balance which enables us both to retain repeat programs while being more competitive in bidding on new programs.

The expected decrease in defense spending has also enhanced the competitive environment and pricing pressures. Substantially all of our business is attributable to component manufacturing for large military and industrial programs. As the prime contractors incur greater competition for fewer defense programs, we expect corollary pricing pressure at the sub-contractor level.

Our competitive edge in pricing for repeat programs has two associated risks: (i) customer concentration and (ii) customer strategies of diffusing reliance on single-sourcing for component products. The latter also presents opportunities for the Company with prime contractors with whom we do not currently have significant business relationships.

The Company’s backlog was $36.9 million at March 31, 2012, which included $24.4 million from two customers compared to $41.5 million at March 31, 2011, which included $29.9 million from three significant customers. The backlog for the Company represents the estimated remaining sales value of work to be performed under prior contracts.

The sales backlog gives the Company a solid base of future sales. Based upon the backlog and our anticipated schedule for the fulfillment of orders, management expects net sales revenues in fiscal year 2012 to exceed fiscal year 2011 net sales revenues and believes that we have a sound foundation for sales in fiscal year 2013.

In addition to the backlog, we currently have outstanding quotations of $41.3 million in connection with repeat programs and $2.7 million for new programs. However, there can be no assurance that the Company will acquire any or all of the anticipated orders described above, many of which are subject to allocations of the United States Department of Defense spending and factors affecting the defense industry and military procurement generally.

Net sales to two significant customers represented 67.9% and 69.7% of the Company’s total sales for the three month periods ended March 31, 2012 and 2011, respectively. Net sales to two significant customers represented 59.6% and 61.1% of the Company’s total sales for the nine month periods ended March 31, 2012 and 2011, respectively. Historically, a small number of customers have accounted for a large percentage of the Company’s total sales in any given fiscal year. Even though our business tends to be concentrated in several customers, the makeup of those customers sometimes changes from year to year.

Our strategic objective, associated with our pricing review noted above, is to broaden our customer base and thereby lower the concentration of sales, mitigate excessive reliance upon a single major product of a particular program and minimize the impact of the loss of a single significant customer. However, the defense industry itself tends to be concentrated with a few large tier one defense contractors which limits the amount of diversity the Company can

achieve with our military customer base.

Management, along with our Board of Directors, continues to evaluate the need and use of the Company's working capital. Capital expenditures are expected to be approximately $300,000 for fiscal year 2012, of which $230,259 was expended through March 31, 2012. We believe that our working capital will be adequate to fund orders, general operations of the business, and regular dividend payments, consistent with past practice.

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Critical Accounting Policies and Estimates

Management believes our most critical accounting policies include revenue recognition and estimates to completion.

A significant portion of our business is comprised of development and production contracts. Generally, revenues on long-term fixed-price contracts are recorded on a percentage of completion basis using units of delivery as the measurement basis for progress toward completion.

Percentage of completion accounting requires judgment relative to expected sales, estimating costs and making assumptions related to technical issues and delivery schedule. Contract costs include material, subcontract costs, labor and an allocation of overhead costs. The estimation of cost at completion of a contract is subject to numerous variables involving contract costs and estimates as to the length of time to complete the contract. Given the significance of the estimation processes and judgments described above, it is possible that materially different amounts of expected sales and contract costs could be recorded if different assumptions were used, based on changes in circumstances, in the estimation process. When a change in expected sales value or estimated cost is determined, changes are reflected in current period earnings.

Results of Operations

Net sales for the three months ended March 31, 2012 were $7,661,946 as compared to $7,005,795 for the same period in 2011, representing a 9.4% increase. Net sales for the nine months ended March 31, 2012 were $23,921,627 as compared to $19,613,467 for the same period in 2011, representing a 22% increase. Generally, these fluctuations can be attributed to the contract specific nature of the Company's business. The increase for the three months ended March 31, 2012 was primarily the result of increased transformer shipments on existing programs offset by a decrease in power supply shipments. The increase for the nine months ended March 31, 2012 was primarily due to the shipment of a high power radar system that the Company does not regularly build and an overall increase in power supply shipments on repeat programs for major customers.

For the three months ended March 31, 2012 and 2011 gross profits were $2,404,390 and $2,047,156, respectively. Gross profit as a percentage of sales was 31.4% and 29.2%, for the three months ended March 31, 2012 and 2011, respectively. For the nine months ended March 31, 2012 and 2011 gross profits were $6,588,058 and $5,322,487, respectively. Gross profit as a percentage of sales was 27.5% and 27.1%, for the nine months ended March 31, 2012 and 2011, respectively. The primary factors in determining gross profit and net income are overall sales levels and product mix. The gross profits on mature products and build to print contracts are higher as compared to products which are still in the engineering development stage or in the early stages of production. In any given accounting

period the mix of product shipments between higher margin mature programs and less mature programs, including loss contracts, has a significant impact on gross profit and net income. The increased gross profit in the three months ended March 31, 2012, was primarily the result of higher net sales on mature programs with only minor cost overruns related to loss contracts. The slight gross profit percentage increase in the nine months ended March 31, 2012 as compared to March 31, 2011 was primarily the result of higher net sales on mature programs offset by one large order shipped during the first quarter that had a lower gross profit percentage than the average gross profit percentage from the previous period. This order was for a high power radar system.

Selling, general and administrative expenses remained consistent and were $663,625 and $663,544 for the three months ended March 31, 2012 and March 31, 2011, respectively. Selling, general and administrative expenses remained consistent and were $2,097,317 and $2,100,027 for the nine months ended March 31, 2012 and March 31, 2011, respectively.

Interest and dividend income for the three months ended March 31, 2012 remained consistent when compared to the three months ended March 31, 2011, due to a leveling of interest rates and related interest income on the Company's cash and cash equivalents and investment securities. For the nine months ended March 31, 2012 other income decreased due to a decrease in funds received related to an insurance claim.

The effective income tax rate at March 31, 2012 and 2011 was 28.4% and 28.2%, respectively. The effective tax rate is less than the statutory tax rate mainly due to the benefit the Company receives on its "qualified production activities" under The American Jobs Creation Act of 2004 and the benefit derived from the ESOP dividends paid on allocated shares.

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Net income for the three months ended March 31, 2012, was $1,262,863 or $.58 per share, both basic and diluted compared to $1,012,031 or $.47 and $.46 per share, basic and diluted, respectively, for the three months ended March 31, 2011. Net income for the nine months ended March 31, 2012, was $3,260,630 or $1.50 and $1.48 per share, basic and diluted, respectively, compared to $2,415,317 or $1.12 and $1.11 per share, basic and diluted, respectively, for the nine months ended March 31, 2011. The increase in net income per share for the three and nine months ended March 31, 2012 was mainly due to higher sales and gross profit.

Liquidity and Capital Resources

The Company's working capital is an appropriate indicator of the liquidity of its business, and during the past three fiscal years, the Company, when possible, has funded all of its operations with cash flows resulting from operating activities and when necessary from its existing cash and investments. The Company did not borrow any funds during the last two fiscal years.

The Company's working capital as of March 31, 2012 and 2011 was approximately $25.9 million and $24.1 million, respectively. During the three months ended March 31, 2012 and 2011 the Company repurchased 1,645 and 19,794 shares, respectively, of its common stock from the Company's Employee Retirement Plan and Trust ("ESOP") for a purchase price of $40,385 and $491,584, respectively. During the nine months ended March 31, 2012 and 2011 the Company repurchased 6,269 and 23,342 shares, respectively, of its common stock from the Company's Employee Retirement Plan and Trust ("ESOP") for a total purchase price of $143,731 and $575,246, respectively. Under existing authorizations from the Company's Board of Directors, as of March 31, 2012, management is authorized to purchase an additional $1,856,268 of Company stock.

	Nine Months Ended March 31,	
	2012	2011
Net cash provided by operating activities	$ 5,523,963	$ 3,807,250
Net cash (used in) provided by investing activities	(1,740,495)	3,572,697
Net cash used in financing activities	(3,608,690)	(3,883,379)

Net cash provided by operating activities fluctuates between periods primarily as a result of differences in net income, the timing of the collection of accounts receivable, purchase of inventory, level of sales and payment of accounts payable. Net cash used in investing activities increased in the first nine months of fiscal 2012 due to the amount of investment securities purchased during the current period. The decrease in cash used in financing activities is due primarily to a decreased purchase of Treasury Stock.

The Company currently believes that the cash flow generated from operations and when necessary, from cash and cash equivalents, will be sufficient to meet its long-term funding requirements for the foreseeable future.

During the nine months ended March 31, 2012 and 2011, the Company expended $230,259 and $590,503, respectively, for plant improvements and new equipment. The Company had budgeted approximately $300,000 for new equipment and plant improvements in fiscal 2012. Management anticipates that the funds required will be available from current operations.

The Company at certain times enters into standby letters of credit agreements with financial institutions primarily relating to the guarantee of future performance on certain contracts. Contingent liabilities on outstanding standby letters of credit agreements aggregated to zero at March 31, 2012 and March 31, 2011.

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CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE

SECURITIES LITIGATION REFORM ACT OF 1995

This report contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The terms "believe," "anticipate," "intend," "goal," "expect," and similar expressions may identify forward-looking statements. These forward-looking statements represent the Company's current expectations or beliefs concerning future events. The matters covered by these statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those set forth in the forward-looking statements, including the Company's dependence on timely development, introduction and customer acceptance of new products, the impact of competition and price erosion, supply and manufacturing constraints, potential new orders from customers and other risks and uncertainties. The foregoing list should not be construed as exhaustive, and the Company disclaims any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is a smaller reporting company as defined under Securities and Exchange Commission Rule 12b-2. Pursuant to the exemption available to smaller reporting company issuers under Item 305 of Regulation S-K, quantitative and qualitative disclosures about market risk, the Company is not required to provide the information for this item.

Item 4. Controls and Procedures

(a) The Company's management, with the participation of the Company's chief executive officer and chief financial officer, carried out an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

(b) There have been no changes in our internal controls over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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PART II: Other Information and Signatures

Item 1. Legal Proceedings
None

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Securities Sold - For the three and nine month period ended March 31, 2012, the Company sold 0 and 2,331 shares to the ESOP respectively. The aggregate gross proceeds from the shares of common stock sold were $0 and $19,231 respectively. The securities were sold for cash and the sales were made without registration under the Securities Act in reliance upon the exemption from registration afforded under Section 4(2) of the Securities Act of 1933. Proceeds were used for general working capital purposes.

(c) Securities Repurchased

Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan or Program (1)
March 1 to March 31, 2012	1,645	$24.55	1,645	$1,856,268

(1) Pursuant to a prior Board of Directors authorization, as of March 31, 2012 the Company can repurchase up to $1,856,268 of its common stock pursuant to an ongoing plan.

Item 3 Defaults Upon Senior Securities
None

Item 4 Mine Safety Disclosures
Not Applicable

Item 5. Other Information
None

Item 6. Exhibits

31.1 Certification of the Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of the Principal Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of the Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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S I G N A T U R E S

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

ESPEY MFG. & ELECTRONICS CORP.

/s/ Mark St. Pierre
Mark St. Pierre, President and
Chief Executive Officer

/s/ David O'Neil
David O'Neil, Treasurer and
Principal Financial Officer

May10, 2012

Date