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ESPEY MFG & ELECTRONICS CORP  
Form 10QSB  
November 10, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-QSB

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

For the Quarterly Period Ended September 30, 2005

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number I-4383

ESPEY MFG. & ELECTRONICS CORP.

-----  
(Exact name of registrant as specified in 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)

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

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES  NO

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

| Class                             | Outstanding at November 10, 2005 |
|-----------------------------------|----------------------------------|
| -----                             | -----                            |
| Common stock, \$.33-1/3 par value | 1,151,212 shares                 |

Transitional Small Business Disclosure Format YES  NO

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ESPEY MFG. & ELECTRONICS CORP.  
Quarterly Report on Form 10-QSB  
I N D E X

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PART I: Financial Information

ESPEY MFG. & ELECTRONICS CORP.

Balance Sheet (Unaudited)

September 30, 2005

-----  
A S S E T S

ASSETS:

Cash and cash equivalents 2005  
September 30,  
-----  
\$ 9,014,126

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|   |               |
|---|---------------|
| Short term investments  | 3,360,000     |
| Trade accounts receivable, net  | 2,919,461     |
| Other receivables   | 9,455         |
| Inventories:  |               |
| Raw materials and supplies  | 1,754,412     |
| Work-in-process   | 2,723,012     |
| Costs relating to contracts in process, net of advance payments of \$97,758 at September 30, 2005 | 6,389,404     |
|   | -----         |
| Total inventories   | 10,866,828    |
|   | -----         |
| Deferred income taxes   | 135,997       |
| Prepaid expenses and other current assets   | 636,946       |
|   | -----         |
| Total current assets  | 26,942,813    |
|   | -----         |
| Property, plant and equipment, net  | 2,898,312     |
|   | -----         |
| Total assets  | \$ 29,841,125 |
|   | =====         |

See accompanying notes to the financial statements.

(Continued)

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ESPEY MFG. & ELECTRONICS CORP.

Balance Sheet (Unaudited), Continued

September 30, 2005

-----  
LIABILITIES AND STOCKHOLDERS' EQUITY

|  |               |
|--|---------------|
|  | 2005          |
|  | September 30, |
|  | -----         |
| LIABILITIES AND STOCKHOLDERS' EQUITY:        |               |
| Accounts payable                             | \$ 841,463    |
| Accrued expenses:                            |               |
| Salaries, wages and commissions              | 92,083        |
| Employees' insurance costs                   | --            |
| Vacation                                     | 442,488       |
| ESOP payable                                 | 83,901        |
| Other  | 48,103        |
| Payroll and other taxes withheld and accrued | 44,266        |
| Income taxes payable                         | 178,221       |

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|   |               |
|---|---------------|
| Total current liabilities   | 1,730,525     |
| Deferred income taxes   | 280,557       |
| Total liabilities   | 2,011,082     |
| Common stock, par value .33-1/3 per share. Authorized 10,000,000 shares; issued 1,514,937 shares on September 30, 2005<br>Outstanding 1,001,212 on September 30, 2005 | 504,979       |
| Capital in excess of par value  | 12,405,915    |
| Retained earnings   | 25,352,395    |
| Less: Cost of 150,000 Unearned ESOP Shares on September 30, 2005  | (4,335,000)   |
| Cost of 363,725 Treasury shares on September 30, 2005   | (6,098,246)   |
| Total stockholders' equity  | 27,830,043    |
| Total liabilities and stockholders' equity  | \$ 29,841,125 |

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.

Statements of Income (Unaudited)

Three Months Ended September 30, 2005 and 2004

|  | Three Months |              |
|--|--------------|--------------|
|  | 2005         | 2004         |
| Net sales                                    | \$ 4,560,574 | \$ 4,730,327 |
| Cost of sales                                | 3,680,284    | 4,081,185    |
| Gross profit                                 | 880,290      | 649,142      |
| Selling, general and administrative expenses | 669,719      | 600,679      |
| Operating income                             | 210,571      | 48,463       |
| Other income (expense)                       |              |              |
| Interest and dividend income                 | 98,934       | 34,870       |
| Other  | (2,823)      | 3,217        |

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|  |            |           |
|--|------------|-----------|
|  | -----      | -----     |
|  | 96,111     | 38,087    |
|  | -----      | -----     |
| Income before income taxes                     | 306,682    | 86,550    |
| Provision for income taxes                     | 88,938     | 25,965    |
|  | -----      | -----     |
| Net income                                     | \$ 217,744 | \$ 60,585 |
|  | =====      | =====     |
| Net income per share:                          |            |           |
| Basic  | \$ .22     | \$ .06    |
| Diluted  | \$ .21     | \$ .06    |
|  | -----      | -----     |
| Weighted average number of shares outstanding: |            |           |
| Basic  | 1,008,582  | 1,013,160 |
| Diluted  | 1,027,471  | 1,020,880 |
|  | =====      | =====     |

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.  
Statements of Cash Flows (Unaudited)  
Three Months Ended September 30, 2005 and 2004

|   | September 30,<br>2005 | September 30,<br>2004 |
|---|-----------------------|-----------------------|
|   | -----                 | -----                 |
| Cash Flows From Operating Activities:   |                       |                       |
| Net income  | \$ 217,744            | \$ 60,585             |
| Adjustments to reconcile net income to net cash provided by operating activities: |                       |                       |
| Depreciation  | 128,874               |                       |
| ESOP compensation expense   | 106,401               |                       |
| Loss on disposal of assets  | 8,077                 |                       |
| Deferred income tax   | (17,500)              |                       |
| Changes in assets and liabilities:  |                       |                       |
| Decrease (increase) in trade receivables, net                                     | 73,779                |                       |
| Increase in other receivables   | (6,282)               |                       |
| (Increase) decrease in inventories  | (499,276)             |                       |
| (Increase) decrease in prepaid expenses and other current assets                  | (300,951)             |                       |
| Increase in accounts payable  | 462,692               |                       |
| Increase in accrued salaries, wages and commissions                               | 29,805                |                       |
| Increase in accrued employees' insurance costs                                    | --                    |                       |
| (Decrease) increase in other accrued expenses                                     | (5,680)               |                       |
| Decrease in vacation accrual  | (55,527)              |                       |
| Increase in payroll and other taxes withheld and accrued                          | 8,289                 |                       |
| Decrease in income taxes payable  | (133,907)             |                       |

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|   |             |       |
|---|-------------|-------|
| Decrease in ESOP payable                            | (22,500)    |       |
|   | -----       | ----- |
| Net cash (used in) provided by operating activities | (5,962)     |       |
|   | -----       | ----- |
| Cash Flows From Investing Activities:               |             |       |
| Unearned ESOP Shares                                | (4,335,000) |       |
| Additions to property, plant & equipment            | (50,426)    |       |
| Purchase of short-term investments                  | (1,920,000) |       |
| Maturity of short-term investments                  | 1,632,000   |       |
|   | -----       | ----- |
| Net cash used in investing activities               | (4,673,426) |       |
|   | -----       | ----- |
| Cash Flows From Financing Activities:               |             |       |
| Sale of treasury stock                              | 4,396,424   |       |
| Dividends on common stock                           | (149,903)   |       |
| Purchase of treasury stock                          | (417,684)   |       |
| Proceeds from exercise of stock options             | 61,170      |       |
|   | -----       | ----- |
| Net cash provided by (used in) financing activities | 3,890,007   |       |
|   | -----       | ----- |
| Decrease in cash and cash equivalents               | (789,381)   |       |
| Cash and cash equivalents, beginning of period      | 9,803,507   | 12,   |
|   | -----       | ----- |
| Cash and cash equivalents, end of period            | 9,014,126   | 11,   |
|   | =====       | ===== |
| Income Taxes Paid                                   | \$ 240,345  | \$    |
|   | =====       | ===== |

See accompanying notes to the financial statements.

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. These financial statements should be read in conjunction with the Company's most recent audited financial statements included in its 2005 Form 10-K.

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

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Unearned ESOP shares are released or committed-to-be-released the shares become outstanding for earnings-per-share computations.

### Note 3. Stock Based Compensation

The Company has elected to account for its stock-based compensation plans under the intrinsic value-based method of accounting as permitted by SFAS No. 123 and as prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations including FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation - An Interpretation of APB No. 25," in accounting for its fixed stock option plans. Under this method, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price.

The following table illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of SFAS no. 123 to stock-based employee compensation.

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|  | Three Months<br>Ended September 30, |           |
|--|-------------------------------------|-----------|
|  | 2005                                | 2004      |
| Net income as reported   | \$ 217,744                          | \$ 60,585 |
| Deduct: Total stock-based<br>employee compensation<br>expense determined under<br>fair value based method<br>for all awards, net of<br>related tax effects | (4,858)                             | (8,377)   |
| Pro forma net income   | \$ 212,886                          | \$ 52,208 |
| Net income per share:  |                                     |           |
| Basic-as reported  | \$ .22                              | \$ .06    |
| Basic-pro forma  | \$ .21                              | \$ .05    |
| Diluted-as reported  | \$ .21                              | \$ .06    |
| Diluted-pro forma  | \$ .21                              | \$ .05    |

### Note 4. Commitments and Contingencies

The Company has entered 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 \$39,300 at September 30, 2005. The Company does not expect to fund any of the amounts under the standby letters of credit. As a government contractor, the Company is continually subject to audit by various agencies of the U.S. Government to determine compliance with various procurement laws and regulations. As a result of such audits and as part of normal business operations of the Company, various claims and charges are asserted against the Company. It is not possible at this time to predict the outcome of all such

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actions. However, management is of the opinion that it has good defenses against such actions and believes that none of these matters will have a material effect on the consolidated financial position, results of operations or cash flows of the Company.

### Note 5. Recently Issued Accounting Standards

In December 2004, the FASB issued SFAS No. 123R, "Share Based Payment." SFAS No. 123R requires companies to recognize in the income statement the grant-date fair value of stock options and other equity-based compensation issued to employees. SFAS No. 123R was originally effective for interim and annual periods beginning after December 15, 2005. The effective date has been delayed by the SEC until annual periods beginning after December 15, 2005. The SFAS No. 123R is not expected to have a material impact on the Company's results of operations and financial condition.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets - Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions. SFAS No. 153 requires that exchanges should be recorded and measured at the fair value of the assets exchanged, with certain exceptions. SFAS No. 153 is effective for nonmonetary exchanges occurring in fiscal periods beginning after June 15, 2005. The adoption of SFAS No. 153 is not expected to have a significant impact on the Company's results of operations or financial position.

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In June 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections", a replacement of APB Opinion No. 20, "Accounting Changes", and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements". SFAS No. 154 changes the requirements of the accounting for and reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles required recognition via a cumulative effect adjustment within net income of the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements, unless it is impractical to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any of the existing accounting pronouncements. We do not believe adoption of SFAS No. 154 will have a material effect on our consolidated financial position, results of operations or cash flows.

### 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. Prior to July 15, 2005, the ESOP owned 230,120 shares, all of which were allocated to employees. On July 15, 2005, pursuant to a Stock Purchase Agreement dated as of such date, the Company, by selling 150,000 shares of its common stock, par value \$0.33 1/3 per share, to the Espey Mfg. & Electronics Corp. Employee Stock Ownership Plan Trust, provided more shares to be allocated to employees for services rendered over the next 15 years. The ESOP paid \$28.90 per share, for an aggregate purchase price of \$4,335,000. The determination of the purchase price was based on a fairness opinion obtained by an independent valuation firm. The ESOP borrowed from the Corporation an amount equal to the purchase price. The loan will be repaid in fifteen (15) equal annual installments of principal and the unpaid balance will bear interest at a fixed rate of 6.25% per annum, the "prime rate" as quoted in The Wall Street Journal on the date of closing.

The Board of Directors of the Company had approved a purchase price per share



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equal to a 5% discount on the average trading price of the Company's common stock on the American Stock Exchange on the date before closing, but in no event greater than the fair market value as determined by an independent valuation firm retained by the ESOP. The average trading price of the Company's common stock on the American Stock Exchange on July 14, 2005 was \$30.72.

In making the sale, the Company relied on the exemption from registration under Section 4(2) of the Securities Act of 1933, as amended, because the shares sold were offered only to the ESOP.

After giving effect to the transaction the ESOP owned 380,120 shares of the Company's 1,158,294 outstanding shares of common stock as of July 15, 2005.

The Company makes annual contributions to the ESOP equal to the ESOP's debt service less dividends 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 Statement of Position 93-6. 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 \$106,401 for the quarter ended September 30, 2005. The ESOP shares as of September 30 were as follows:

|   |             |
|---|-------------|
| Allocated Shares                                | 219,738     |
| Committed-to-be-released shares                 | 3,229       |
| Unreleased shares                               | 146,771     |
|   | -----       |
| Total shares held by the ESOP                   | 369,738     |
|   | =====       |
| Fair value of unreleased shares at September 30 | \$5,144,324 |
|   | =====       |

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### Item 2. Management's Discussion and Analysis

#### Overview

Espey Mfg. & Electronics Corp. (the "Company") located in Saratoga Springs, New York, is engaged principally in the development, design, production and sale of specialized electronic power supplies, a wide variety of transformers and other types of iron-core components, and electronic system components. In some cases, the Company manufactures such products in accordance with pre-developed mechanical and electrical requirements ("build to print"). In other cases, the Company is responsible for both the overall design and manufacture of the product. The Company does not generally manufacture standardized components and does not have a product line. The products manufactured by the Company find application principally in (i) shipboard and land based radar, (ii) locomotives, (iii) aircraft, (iv) short and medium range communication systems, (v) navigation systems, and (vi) land based military vehicles.

Business is solicited from large industrial manufacturers and defense companies, the government of the United States and 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 the United States Department of Defense and generally is automatically solicited by such agencies

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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.

There is competition in all classes of products manufactured by the Company from divisions of the largest electronic companies, as well as from 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.

Management is optimistic about the future of the Company. In the first three months of fiscal 2006, the Company received approximately \$18.1 million in new orders. These orders include both follow-on production quantities for mature products, and engineering development orders which will enable the Company to utilize its engineering expertise in developing new customer specific products. Some of these products, once developed, will be produced in the Company's manufacturing facility and are expected to provide large production order quantities over several years. These orders are in line with the Company's strategy of getting involved in long-term high quantity military and industrial products.

The sales backlog of approximately \$45.3 million at September 30, 2005 gives the Company a solid base of future sales and, therefore, management expects a significant increase in sales during fiscal 2006 as compared to fiscal 2005. In addition to the backlog, the Company currently has outstanding quotations representing in excess of \$27 million in the aggregate for both repeat and new programs. Many potential orders are currently being discussed and negotiated with our customers.

The outstanding quotations encompass various new and previously manufactured power supplies, transformers, and subassemblies. 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 defense spending and factors affecting the defense industry and military procurement generally.

The total backlog for the Company of \$45.3 million at September 30, 2005, up \$29.7 million over September 30, 2004, represents the estimated remaining sales value of work to be performed under firm contracts. The funded portion of this backlog at September 30, 2005 is approximately \$36.6 million. This includes items that have been authorized and appropriated by Congress and/or funded by the customer. The unfunded backlog is approximately \$8.7 million and represents firm multi-year orders for which funding

has not yet been appropriated by Congress. While there is no guarantee that future budgets and appropriations will provide funding for a given program, management has included in unfunded backlog only those programs that it believes are likely to receive funding. The unfunded backlog at September 30, 2004 was zero. The backlog at September 30, 2005, as discussed above, includes significant orders for military and industrial power supplies, and contracts to manufacture certain customer products in accordance with pre-engineered requirements.

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Management, along with the Board of Directors, continues to evaluate the need and use of the Company's working capital. Expectations are that the working capital will be required to fund the increase in orders over the next several quarters, dividend payments, and general operations of the business. Also, the Mergers and Acquisitions Committee of the Board of Directors continues to evaluate potential strategic alternatives on a periodic basis.

### Critical Accounting Policies and Estimates

We believe our most critical accounting policies include revenue recognition and cost estimation on our contracts.

### Revenue Recognition and Estimates

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 contract costs could be recorded if different assumptions were used, based on changes in circumstances, in the estimation of cost at completion. 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 September 30, 2005 and 2004, were \$4,560,574 and \$4,730,327, respectively. The 3.6% decrease in net sales for the three months ended September 30, 2005 as compared to 2004, was a result of shipments being delayed due to customer sourcing requirements and quality control inspections that could not be performed by the Company's customers until after the quarter ended. New orders received in first quarter of fiscal 2006 were approximately \$18.1 million compared to approximately \$4.8 in the first quarter of fiscal 2005.

The primary factor in determining gross profit and net income is product mix. The gross profits on mature products and build to print contracts are higher than with respect to the 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.

For the three months ended September 30, 2005 and 2004 gross profits were \$880,290, and \$649,142, respectively. Gross profit as a percentage of sales was 19.3% and 13.7%, for the three months ended September 30, 2005 and 2004, respectively. The improved gross profit percentage in the three months ended September 30, 2005, relates to favorable product mix, offset partially by decreased sales and higher ESOP contribution expense. ESOP contribution expense included in cost of sales was \$85,120 for the three months ended September 30, 2005, and zero for the three months ended September 30, 2004, (see note 6 to the financial statements). Management continues to evaluate the Company's workforce to ensure that production and overall execution of the backlog orders and additional anticipated orders are successfully performed. Employment at

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September 30, 2005 was 173 people compared to 178 people at September 30, 2004.

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Selling, general and administrative expenses were \$669,719, for the three months ended September 30, 2005, an increase of \$69,040, or 11.5% as compared to the same period in the prior year. This increase is primarily due to increased selling salaries and ESOP contribution expense, offset partially by a decrease in professional fees.

Other income for three months ended September 30, 2005 increased as compared to the three months ended September 30, 2004 due to increased interest income on the Company's cash equivalents and short-term investments due to higher interest rates. The Company does not believe that there is significant risk associated with its investment policy, since at September 30, 2005 all of the investments are primarily represented by short-term liquid investments including certificates of deposit and money market accounts.

The effective income tax rate at September 30, 2005 and 2004 was 29.0% and 30.0%, respectively. The effective tax rate is less than the statutory tax rate mainly due to the foreign exportation benefit the Company receives on its international sales, the Qualified Production Activities benefit, and the benefit derived from the ESOP dividends paid on allocated shares.

Net income for the three months ended September 30, 2005, was \$217,744 or \$.22 and \$.21 per share, basic and diluted, respectively, compared to \$60,585 or \$.06 per share, both basic and diluted, for the three months ended September 30, 2004. The increase in net income per share was due to improved gross profit as a percentage of sales, offset partially by the decrease in sales and increase in selling, general and administrative expenses.

### 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 three fiscal years. Management has available a \$3,000,000 line of credit to help fund further growth or working capital needs, if necessary, but does not anticipate the need for any borrowed funds in the foreseeable future.

The Company's working capital as of September 30, 2005 was \$25.2 million. During the three months ended September 30, 2005 and 2004 the Company repurchased 12,142, and 4,014 shares, respectively, of its common stock from the Company's Employee Retirement Plan and Trust ("ESOP"), for a total purchase price of \$417,685 and \$90,315, respectively. Under existing authorizations from the Company's Board of Directors, as of September 30, 2005, management is authorized to purchase an additional \$582,315 million of Company stock.

|   | Three Months Ended September 30, |            |
|---|----------------------------------|------------|
|   | 2005                             | 2004       |
| Net cash (used in) provided by operating activities | \$ (5,962)                       | \$ 298,368 |
| Net cash used in investing activities               | 4,673,426                        | 497,761    |
| Net cash provided by (used in) financing activities | 3,890,007                        | (238,346)  |

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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, purchases of inventory, receipt of progress payments, level of sales and payments of accounts payable. Net cash used in investing activities increased in the first quarter of fiscal 2006 due to the purchase of short-term investments and the ESOP transaction described in note 6. The increase in cash provided by financing activities is due primarily to the sale of treasury shares to the ESOP in the first quarter of fiscal 2006.

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

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Management believes that the Company's reserve for bad debts of \$3,000 is adequate given the customers with whom the Company does business. Historically, bad debt expense has been minimal.

During the three months ended September 30, 2005 and 2004, the Company expended \$50,426 and \$113,761, respectively, for plant improvements and new equipment. The Company has budgeted approximately \$500,000 for new equipment and plant improvements in fiscal 2006. Management presently anticipates that the funds required will be available from current operations.

The Company has entered 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 \$39,300 at September 30, 2005. The Company does not expect to fund any of the amounts under the standby letters of credit.

### Other Matters

An Employee Retirement Plan and Trust ("ESOP") was established for the eligible non-union employees of the Company, effective as of July 1, 1988. The ESOP used the proceeds of a loan from the Company made on June 5, 1989 to purchase 316,224 shares of the Company's common stock for approximately \$8,400,000 and the Company contributed approximately \$400,000 in 1989 to the ESOP, which was used by the ESOP to purchase an additional 15,000 shares of the Company's common stock.

Each year the Company made contributions to the ESOP, which were used to make loan interest and principal payments. With each loan and interest payment, a portion of the common stock is allocated to participating employees. As of September 30, 2005, there were 219,738 shares allocated to participants. Dividends attributable to allocated shares were likewise allocated to the participants' accounts, whereas the dividends on unallocated shares were used toward the loan repayment, thus reducing the Company's required contribution.

The loan from the Company to the ESOP was repayable in annual installments of \$1,039,605, including interest through June 30, 2004. Interest was payable at a rate of 9% per annum. The Company's receivable from the ESOP was recorded as common stock subscribed in the accompanying balance sheet.

Effective June 30, 2004 the loan from the Company to the ESOP was paid in full and all shares have been allocated to participant's accounts.

On July 15, 2005, pursuant to a Stock Purchase Agreement dated as of such date,

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the Company sold 150,000 shares of its common stock, par value \$0.33 1/3 per share, to the Espey Mfg. & Electronics Corp. Employee Stock Ownership Plan Trust (the "ESOP"). The ESOP paid \$28.90 per share, for an aggregate purchase price of \$4,335,000. The determination of the purchase price was based on a fairness opinion obtained by an independent valuation firm. The ESOP borrowed from the Corporation an amount equal to the purchase price. The loan will be repaid in fifteen (15) equal annual installments of principal and the unpaid balance will bear interest at a fixed rate of 6.25% per annum, the "prime rate" as quoted in The Wall Street Journal on the date of closing.

The Board of Directors of the Company approved a purchase price per share equal to a 5% discount on the average trading price of the Company's common stock on the American Stock Exchange on the date before closing, but in no event greater than the fair market value as determined by an independent valuation firm retained by the ESOP. The average trading price of the Company's common stock on the American Stock Exchange on July 14, 2005 was \$30.72.

In making the sale, the Company relied on the exemption from registration under Section 4(2) of the Securities Act of 1933, as amended, because the shares sold were offered only to the ESOP.

After giving effect to the transaction the ESOP owned 380,120 shares of the Company's 1,158,294 outstanding shares of common stock as of July 15, 2005.

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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. 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-QSB. 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

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during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

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-month period ended September 30, 2005, 3,300 stock options were exercised under the Company's existing stock option plan. In addition to the stock option shares, the Company sold 1,760 shares to the ESOP. 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 (or Approximate) Dollar Value of Shares that May Be Purchased Under the Program |
|-----------------------------|----------------------------------|------------------------------|--|---|
| August 1 to August 31, 2005 | 12,142                           | \$34.40                      | 12,142   | \$582,315   |
| Total                       | 12,142                           |                              | 12,142   |   |

(1) Pursuant to a prior Board of Directors authorization, as of September 30, 2005 the Company can repurchase up to \$582,315 of its common stock pursuant to an ongoing plan.

Item 3 Defaults on Senior Securities

None

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

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None

Item 5. Other Information

None

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Item 6. Exhibits and Reports on Form 8-K

(a) 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

(b) Reports on Form 8-K

Form 8-K filed July 15, 2005 announcing the unregistered sales of equity securities to the Company's ESOP.

Form 8-K filed August 18, 2005 announcing the issuance of a press release detailing the financial results for the fiscal year ended June 30, 2005.

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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/ Howard Pinsley

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Howard Pinsley, President and  
Chief Executive Officer

/s/ David O'Neil

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David O'Neil, Treasurer and



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Principal Financial Officer

November 10, 2005

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Date