ESPEY MFG & ELECTRONICS CORP
Form 10-Q
February 13, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

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

For the Quarterly Period Ended December 31, 2008

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.

Yes |X| No [ ]

Indicate by check mark whether the registrant is 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 [ ] Accelerated filer [ ]

Non-accelerated filer [ ] Smaller reporting company |X|

Indicated by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No |X|

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

Class	Outstanding at February 11, 2009

Common stock, $.33-1/3 par value 2,329,153 shares

ESPEY MFG. & ELECTRONICS CORP.
Quarterly Report on Form 10-Q
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PART I: FINANCIAL INFORMATION

ESPEY MFG. & ELECTRONICS CORP.
Balance Sheets
December 31, 2008 (Unaudited) and June 30, 2008

2008 December 31,	2008 June 3

ASSETS:

Cash and cash equivalents	$ 1,299,601	$ 6,851,
Short term investments	9,566,000	7,336,
Trade accounts receivable, net	3,039,829	3,646,
Income tax receivable	516,310	276,
Other receivables	6,363	4,
ESOP receivable due to dividends on unallocated shares	246,656	36,
Inventories:		
Raw materials	1,516,264	1,575,
Work-in-process	1,025,538	1,151,
Costs relating to contracts in process, net of advance payments of $830,215 at December 31, 2008 and $959,175 at June 30, 2008	8,803,035	7,461,
Total inventories	11,344,837	10,188,
Deferred income taxes	167,422	169,
Prepaid expenses and other current assets	215,519	355,
Total current assets	26,402,537	28,864,
Property, plant and equipment, net	2,891,876	2,956,
Loan receivable	51,937	65,
Total assets	$29,346,350	$31,886,

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.
Balance Sheets
December 31, 2008 (Unaudited) and June 30, 2008

	2008 December 31,
LIABILITIES AND STOCKHOLDERS' EQUITY:	
Accounts payable	$ 1,894,957
Accrued expenses:	
Salaries, wages and commissions	99,314
Vacation	450,940
ESOP payable	--
Other	66,747
Payroll and other taxes withheld and accrued	47,041
Total current liabilities	2,558,999

Deferred income taxes	114,557
Total liabilities	2,673,556
Common stock, par value $.33-1/3 per share. Authorized 10,000,000 shares; issued 3,029,874 shares on December 31, 2008 and June 30, 2008. Outstanding 2,326,953 and 2,325,902 (includes 213,333 and 225,000 Unearned ESOP Shares on December 31, 2008 and June 30, 2008, respectively)	1,009,958
Capital in excess of par value	13,604,470
Retained earnings	22,051,959
	36,666,387
Less: Unearned ESOP shares	(3,251,248)
Treasury shares, cost of 702,921 shares on December 31, 2008 and 703,972 shares on June 30, 2008	(6,742,345)
Total stockholders' equity	26,672,794
Total liabilities and stockholders' equity	$ 29,346,350

See accompanying notes to the financial statements.

ESPEY MFG. & ELECTRONICS CORP.
Statements of Income (Unaudited)
Three and Six Months Ended December 31, 2008 and 2007

	Three Months		
	2008	2007	2008
Net sales	$ 6,194,177	$ 6,732,144	$ 12,247
Cost of sales	5,568,247	5,049,559	10,470
Gross profit	625,930	1,682,585	1,777
Selling, general and administrative expenses	789,585	701,819	1,467
Operating (loss) income	(163,655)	980,766	309
Other income			
Interest and dividend income	92,969	203,324	195

Other	4,672	29,077	15
	97,641	232,401	211
(Loss) income before income taxes	(66,014)	1,213,167	521
(Benefit) provision for income taxes	(23,602)	416,081	165
Net (loss) income	$ (42,412)	$ 797,086	$ 355
Net (loss) income per share:			
Basic	$ (.02)	$ .38	$
Diluted	$ (.02)	$ .37	$
Weighted average number of shares outstanding:			
Basic	2,107,257	2,074,789	2,104
Diluted	2,114,363	2,109,650	2,115
Dividends per share:	$ 1.7250	$ .1750	$ 1.

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.
Statements of Cash Flows (Unaudited)
Six Months Ended December 31, 2008 and 2007

	December 2008	
Cash Flows From Operating Activities:		
Net income	$ 355,884	$
Adjustments to reconcile net income to net cash provided by operating activities:		
Excess tax benefits from share-based compensation	30,245	
Stock-based compensation	58,166	
Depreciation	247,973	
ESOP compensation expense	228,903	
Loss on disposal of assets	2,542	
Deferred income tax	(15,590)	
Changes in assets and liabilities:		
Decrease (increase) in trade receivables, net	606,298	
Increase in income taxes receivable	(240,223)	
Increase in other receivables	(2,015)	
Increase in ESOP receivable due to dividends on unallocated shares	(209,847)	
(Increase) decrease in inventories	(1,156,603)	

Decrease in prepaid expenses and other current assets	140,169
Increase (decrease) in accounts payable	1,294,026
Decrease in accrued salaries, wages and commissions	(85,063)
Decrease in vacation accrual	(91,501)
Decrease in ESOP payable	(228,903)
Increase in other accrued expenses	20,494
Increase (decrease) in payroll & other taxes withheld and accrued	4,866
Decrease in income taxes payable	(30,245)
Net cash provided by operating activities	929,576
Cash Flows From Investing Activities:	
Additions to property, plant & equipment	(185,801)
Payment for issuance of loan receivable	--
Proceeds from loan receivable	13,066
Purchase of short term investments	(6,550,000)
Maturity of short term investments	4,320,000
Net cash used in investing activities	(2,402,735)
Cash Flows From Financing Activities:	
Dividends on common stock	(4,100,628)
Purchase of treasury stock	(102,510)
Proceeds from exercise of stock options	93,900
Excess tax benefits from share-based compensation	30,245
Net cash used in financing activities	(4,078,993)
(Decrease) increase in cash and cash equivalents	(5,552,152)
Cash and cash equivalents, beginning of period	6,851,753
Cash and cash equivalents, end of period	1,299,601
Supplemental disclosures of cash flow information:	
Income Taxes Paid	$ 400,000

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-KSB for the year ended June 30, 2008.

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 earnings-per-share computations.

Note 3. Stock Based Compensation

Effective July 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (Revised 2004),"Share-Based Payment" ("SFAS No. 123 (R)"), which amends SFAS No. 123 and supersedes Accounting Principles Board Opinion ("APB") No. 25 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. SFAS No. 123(R) 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. SFAS No.123(R) 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. As allowed under SFAS No. 123(R), the Company elected the modified prospective method of adoption, under which compensation cost is recognized in the financial statements beginning with the effective date of SFAS No. 123(R) for all share-based payments granted after that date, and for all unvested awards granted prior to the effective date of SFAS No. 123(R). Accordingly, prior period amounts have not been restated.

Total stock-based compensation expense recognized in the Statement of Income for the three months ended December 31, 2008 and 2007, was $29,083 and $32,491, respectively, before income taxes. The related total deferred tax benefit was approximately $2,477 and $2,487, for the three months ended December 31, 2008 and 2007, respectively. Total stock-based compensation expense recognized in the Statement of Income for the six months ended December 31, 2008 and 2007, was $58,166 and $83,331, respectively, before income taxes. The related total deferred tax benefit was approximately $4,954 and $6,504, for the six months ended December 31, 2008 and 2007, respectively. Prior to the adoption of SFAS No. 123(R), the Company presented all tax benefits for deductions resulting from the exercise of stock options as operating cash flows in the Statements of Cash Flows. SFAS No. 123(R) 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 December 31, 2008, there was approximately $89,900 of unrecognized compensation cost related to stock option awards that is expected to be recognized as expense over a period of 1.5 years.

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 supercedes the Company's 2000 Stock Option Plan (the "2000 Plan"). Options covering 400,000 shares are authorized for issuance under the 2007 Plan, of which 34,400 have been granted as of December 31, 2008. While no further grants of options may be made under the 2000 Plan, as of December 31, 2008, 83,100 options were outstanding of which 49,900 are vested and exercisable.

SFAS No. 123(R) 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 stock-based employee compensation for the three and six months ended December 31, 2008 and 2007:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2008	2007	2008	2007
Dividend yield	3.34%	2.59%	3.34%	2.40%
Expected stock price volatility	24.41%	20.50%	24.41%	22.29%
Risk-free interest rate	3.91%	4.80%	3.91%	4.54%
Expected option life (in years)	4.0 yrs	5 yrs	4.0 yrs	5 yrs
Weighted average fair value per share of options granted during the period	$3.59	$3.66	$3.59	$3.84

The Company pays dividends quarterly and does plan to pay dividends in the foreseeable future. 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 the safe harbor calculation under SFAS No. 123.

The following table summarizes stock option activity during the three months ended December 31, 2008:

Employee Stock Options Plan		
Number of	Weighted	Weighted Average

	Shares Subject To Option	Average Exercise Price	Remaining Contractual Term
Balance at July 1, 2008	126,500	$18.40	7.85
Granted	--	--	
Exercised	(6,600)	$14.23	
Forfeited or expired	(2,400)	$17.82	
Balance December 31, 2008	117,500	$18.65	7.94
Exercisable at December 31, 2008	49,900	$16.89	6.81

The intrinsic value of stock options exercised was $18,495 and $179,365, during the six months ended December 31 2008 and 2007, respectively. The intrinsic value of stock options outstanding and exercisable as of December 31, 2008 and 2007 was $90,637 and $207,917, respectively.

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 December 31, 2008. 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 can be asserted against the Company. It is not possible to predict the outcome of such actions. Currently the Company has no claims or assertions pending or threatened against it.

Note 5. Recently Issued Accounting Standards

In May 2008, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard No. 162 ("SFAS 162"), The Hierarchy of Generally Accepted Accounting Principals. SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States. SFAS 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. SFAS 162 does not have a material effect on the company's financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standard No. 161 ("SFAS 161"), Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133. SFAS 161 requires enhanced disclosures about an entity's derivative and hedging activities. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008 with early application encouraged. As such, the Company was required to adopt these provisions at the beginning of the fiscal year ended June 30, 2009. The adoption of the provisions of SFAS 161 will not have a material effect on the Company's financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standard No. 160 ("SFAS 160"), Noncontrolling Interests in Consolidated Financial Statements,

an amendment of ARB No. 51. SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. As such, the Company was required to adopt these provisions on January 1, 2009. The adoption of the provisions of SFAS 160 will not have a material effect on the Company's financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standard No. 141(R) ("SFAS 141(R)"), Business Combinations. SFAS 141(R) establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, an any noncontrolling interest in the acquiree, recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. As such, the Company was required to adopt these provisions January 1, 2009. The adoption of the provisions of SFAS 160 will not have a material effect on the Company's financial statements.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159 ("SFAS 159"), The Fair Value Option for Financial Assets and Financial Liabilities. SFAS 159 provides companies with an option to report selected financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings at each subsequent reporting date. SFAS 159 is effective beginning July 1, 2008. The adoption of the provisions of SFAS 159 did not have a material effect on the Company's financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157 ("SFAS 157"), Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements

that require or permit fair value measurements, but does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those years. SFAS 157 did not have a material effect on the Company's financial statements.

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 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 $110,485 for the quarter ended December 31, 2008 and $228,903 for the six-month period ending December 31, 2008. The ESOP shares as of December 31, 2008 were as follows:

Allocated Shares	437,593
Committed-to-be-released shares	11,667
Unreleased shares	213,333
Total shares held by the ESOP	662,593
Fair value of unreleased shares at December 31, 2008	$3,991,460

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

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, 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.

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 six months of fiscal 2009 were approximately

$11.5 million, representing a 40.4% increase over the amount of new orders received in the first six months of fiscal 2008. These orders are predominately follow-on production quantities for mature products. These orders are in line with the Company's strategy of getting involved in long-term high quantity military and industrial products. The Company's backlog was $44.0 million at December 31, 2008 and is $43.6 million at February 10, 2009, which includes $23.8 million from two significant customers. The backlog for the Company represents the estimated remaining sales value of work to be performed under firm contracts. These contracts include significant orders for military and industrial power supplies, and contracts to manufacture certain customer products in accordance with pre-engineered requirements.

The sales backlog gives the Company a solid base of future sales. Based upon the backlog and the anticipated schedule for the fulfillment of orders, management expects sales for fiscal 2009 to be higher than fiscal 2008 sales. In addition to the backlog, the Company currently has outstanding quotations and potential business representing approximately $49.0 million in the aggregate for both repeat and new programs.

Net sales to two significant customers represented 67.1% and 58.5% of the Company's total sales for the three-month period ended December 31, 2008 and 2007, respectively. Sales to these two customers for the six-month period ended December 31, 2008 and 2007 represented 69.4% and 57.7% of total sales, respectively. While the Company has always had a small number of customers that account for a large percentage of its total sales in any given year, management is pursuing business opportunities involving significant product programs with new and current customers with an overall objective of lowering the concentration of sales and minimizing the impact of a significant customer or excessive reliance upon a single major product program of a particular customer.

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.

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 any 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 options on a periodic basis.

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 December 31, 2008 were $6,194,177 as compared to $6,732,144 for the same period in 2007, representing an 8% decrease. Net sales for the six months ended December 31, 2008 were $12,247,696 as compared to $13,033,930 for the same period in 2007, representing a 6% decrease. Generally, these decreases can be attributed to the contract specific nature of the Company's business. Management expected sales to be higher for the three and six months ended December 31, 2008, however, anticipated shipments of products under two engineering development contracts were delayed for reasons described below.

For the three months ended December 31, 2008 and 2007 gross profits were $625,930 and $1,682,585, respectively. Gross profit as a percentage of sales was 10.1% and 25.0%, for the three months ended December 31, 2008 and 2007, respectively. For the six months ended December 31, 2008 and 2007 gross profits were $1,777,205 and $3,031,695, respectively. Gross profit as a percentage of sales was 14.5% and 23.3%, for the six months ended December 31, 2008 and 2007, respectively. 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 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 decreased gross profit and gross profit percentage in the three and six months ended December 31, 2008, was primarily the result of unexpected losses incurred on two programs with significant engineering and production time required for design efforts. These two programs experienced significant cost overruns in the current quarter due to extended product qualification testing and difficulties moving the products from engineering design into full production. Currently, one program has completed qualification testing and has moved into full production. The other program is still in qualification testing and has made significant progress towards completion. Management is not anticipating any more losses on these two contracts. 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 obtained and executed. Employment of full time equivalents at December 31, 2008 was 171 compared to 175 people at December 31, 2007.

Selling, general and administrative expenses were $789,585 for the three months ended December 31, 2008; an increase of $87,766, compared to the three months ended December 31, 2007. Selling, general and administrative expenses were

$1,467,812 for six months ended December 31, 2008, an increase of $98,440 compared to the six months ended December 31, 2007. The increase for the three and six months ended December 31, 2008, relates primarily to an increase in salaries and an increase in legal and accounting fees.

Other income for the three and six months ended December 31, 2008 decreased as compared to the three and six months ended December 31, 2007 due to decreased

interest income on the Company's cash and cash equivalents and short-term investments. The Company does not believe that there is a significant risk associated with its investment policy, since at December 31, 2008 all of the investments were primarily represented by short-term liquid investments including certificates of deposit and money market funds.

The effective income tax rate at December 31, 2008 and 2007 was 31.7% and 34.3%, 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 and the benefit derived from the ESOP dividends paid on allocated shares.

Net (loss) income for the three months ended December 31, 2008, was $(42,412) or $(.02) per share, both basic and diluted, compared to $797,086 or $.38 and $.37 per share, basic and diluted, respectively, for the three months ended December 31, 2007. Net income for the six months ended December 31, 2008, was $355,884 or $.17 per share, both basic and diluted, compared to $1,388,669 or $.67 and $.65 per share, basic and diluted, for the six months ended December 31, 2007. The decrease in net income per share was primarily due to the loss programs explained above and decreased interest income.

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.

The Company's working capital as of December 31, 2008 and 2007 was approximately $23.8 million and $28.7 million, respectively. During the three months ended December 31, 2008 and 2007 the Company repurchased 2,805 and 8,977 shares, respectively, of its common stock for a total purchase price of $50,471 and $200,905, respectively. Of the total purchases, 800 shares and 8,977 shares, respectively, were purchased from the Company's Employee Retirement Plan and Trust ("ESOP") for a purchase price of $14,400 and $200,905, respectively. All remaining shares were purchased on the open market. During the six months ended December 31, 2008 and 2007 the Company repurchased 5,549 and 25,720 shares, respectively, of its common stock for a total purchase price of $102,510 and $571,763, respectively. Of the total purchases, 800 shares and 25,720 shares, respectively, were purchased from the Company's Employee Retirement Plan and Trust ("ESOP") for a purchase price of $14,400 and $571,763, respectively. All remaining shares were purchased on the open market. Under existing authorizations from the Company's Board of Directors, as of December 31, 2008, management is authorized to purchase an additional $1,897,489 million of Company stock.

	Six Months Ended December 31, 2008	2007
Net cash provided by operating activities	$ 929,576	$ 1,331,627
Net cash used in investing activities	(2,402,735)	(2,899,436)
Net cash used in financing activities	(4,078,993)	(964,821)

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 decreased in the first half of fiscal 2009 due to more short-term investments maturing during the period. The increase in cash used in financing activities and the reduction in the Company's working capital is due primarily to dividends paid on common stock which included a special dividend of $1.50 per share paid in December.

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 six months ended December 31, 2008 and 2007, the Company expended $185,801 and $292,436, respectively, for plant improvements and new equipment. The Company has budgeted approximately $350,000 for new equipment and plant improvements in fiscal 2009. 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 December 31, 2008 and December 31, 2007.

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 4T. 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) None

(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 Appr Dollar V of Sha that Ma Be Purc Under th or Progr
October 1 to October 31, 2008	562	$18.6155	562	$1,937
November 1 to November 30, 2008	1,443	$17.7197	1,443	$1,911
December 1 to December 31, 2008	800	$18.0500	800	$1,897

(1) Pursuant to a prior Board of Directors authorization, as of December 31, 2008 the Company can repurchase up to $1,897,489 of its common stock pursuant to an ongoing plan.

Item 3 Defaults Upon Senior Securities

None

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

(a) The Company's Annual Meeting of Shareholders (the "Annual Meeting") was held on November 21, 2008.

(b) Paul Corr and Michael Wool were re-elected as Class C directors each to serve for a three-year term. Continuing as directors after the Annual Meeting were:

Class A (term expiring 2009): Howard Pinsley
Alvin Sabo

	Carl Helmetag
Class B (term expiring 2010):	Barry Pinsley Seymour Saslow
Class C (term expiring 2011):	Paul J. Corr Michael W. Wool

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(c) The following matters were voted upon at the annual meeting:

The election of two Class C directors. The votes were cast as follows:

Nominee:	Voted For:	Voted Against or Withheld:	Broker Non-Votes:
Paul Corr	2,268,817	21,367	0
Michael Wool	1,773,524	516,660	0

Ratification of Rotenberg & Company LLP, as independent auditors for the Corporation for the fiscal year ending June 30, 2009. The votes were cast as follows:

Shares in favor	2,258,201
Shares against	31,056
Abstentions	926
Broker non-votes	0

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

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

Howard Pinsley, President and
Chief Executive Officer

/s/ David O'Neil

David O'Neil, Treasurer and
Principal Financial Officer

February 12, 2009

Date