ESPEY MFG & ELECTRONICS CORP
Form 10QSB
May 08, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-QSB

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

For the Quarterly Period Ended March 31, 2006

[ ] TRANSISTION 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 [X] NO [ ]

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

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 May 08, 2006
Common stock, $.33-1/3 par value	2,298,562 shares

Transitional Small Business Disclosure Format YES [X] NO [ ]

ESPEY MFG. & ELECTRONICS CORP.

Quarterly Report on Form 10-Q

I N D E X

PART I: FINANCIAL INFORMATION

ESPEY MFG. & ELECTRONICS CORP.
Balance Sheet (Unaudited)
March 31, 2006

ASSETS:

Cash and cash equivalents	$ 7,727,224
Short term investments	4,128,000
Trade accounts receivable, net	2,857,520
Other receivables	8,273

Inventories:	
Raw materials and supplies	1,769,400
Work-in-process	2,377,807
Costs relating to contracts in process, net of advance payments of $397,991 at March 31, 2006	8,423,115
Total inventories	12,570,322
Deferred income taxes	135,997
Prepaid expenses and other current assets	695,331
Total current assets	28,122,667
Property, plant and equipment, net	2,914,869
Total assets	$ 31,037,536
LIABILITIES AND STOCKHOLDERS' EQUITY:	
Accounts payable	$ 1,738,258
Accrued expenses:	
Salaries, wages and commissions	93,135
Vacation	509,689
ESOP payable	256,498
Other	57,825
Payroll and other taxes withheld and accrued	45,311
Income taxes payable	147,871
Total current liabilities	2,848,587
Deferred income taxes	245,557
Total liabilities	3,094,144
Common stock, par value $.33-1/3 per share Authorized 10,000,000 shares; issued 3,029,874 shares on March 31, 2006. Outstanding 2,297,762 (includes 280,626 Unearned ESOP Shares) on March 31, 2006	1,009,958
Capital in excess of par value	12,429,727
Retained earnings	25,131,005
Less: Unearned ESOP Shares	(4,335,000)
Cost of 732,112 Treasury shares on March 31, 2006	(6,292,298)
Total stockholders' equity	27,943,392
Total liabilities and stockholders' equity	$ 31,037,536

See accompanying notes to the financial statements.

ESPEY MFG. & ELECTRONICS CORP.
Statements of Income (Unaudited)

Three and Nine Months Ended March 31, 2006 and 2005

	Three Months 2006	Three Months 2005	Nine Mont[hs] 2006
Net sales	$ 4,677,808	$ 4,219,861	$ 14,294,465
Cost of sales	3,635,543	3,568,971	11,424,550
Gross profit	1,042,265	650,890	2,869,915
Selling, general and administrative expenses	649,101	565,145	1,985,260
Operating income	393,164	85,745	884,655
Other income (expense)			
Interest and dividend income	121,213	66,420	331,123
Other	(213)	7,816	(8,650)
	121,000	74,236	322,473
Income before income taxes	514,164	159,981	1,207,128
Provision for income taxes	149,107	47,994	350,067
Net income	$ 365,057	$ 111,987	$ 857,061
Net income per share:			
Basic	$ 0.18	$ 0.06	$ 0.43
Diluted	$ 0.18	$ 0.05	$ 0.42
Weighted average number of shares outstanding:			
Basic	2,010,173	2,021,342	2,010,580
Diluted	2,041,443	2,046,606	2,048,022
Dividends per share:	$ 0.0900	$ 0.0750	$ 0.2525

As described in note 7, a stock split in the form of a stock dividend of one share of common stock for each share of common stock issued, was paid on December 30, 2005 (all per share and share amounts have been adjusted to reflect this dividend).

See accompanying notes to the financial statements.

ESPEY MFG. & ELECTRONICS CORP.
Statements of Cash Flows (Unaudited)
Nine Months Ended March 31, 2006 and 2005

	March 31,	
	2006	
Cash Flows From Operating Activities:		
Net income	$ 857,061	$
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	403,191	
ESOP compensation expense	332,248	
Loss on disposal of assets	26,741	
Deferred income tax	(52,500)	
Changes in assets and liabilities:		
Decrease (Increase) in trade receivable, net	135,720	(
Increase in other receivables	(5,100)	
(Increase) decrease in inventories	(2,202,770)	
Increase in prepaid expenses and other current assets	(359,336)	(
Increase in accounts payable	1,359,487	
Increase in accrued salaries, wages and commissions	30,857	
Decrease in accrued employees' insurance costs	--	
Increase in vacation accrual	11,674	
Increase in other accrued expenses	4,042	
Increase in payroll and other taxes withheld and accrued	9,334	
Decrease in income taxes payable	(164,257)	(
Decrease in ESOP payable	(75,750)	
Net cash provided by operating activities	310,642	
Cash Flows From Investing Activities:		
Unearned ESOP Shares	(4,335,000)	
Additions to property, plant and equipment	(360,464)	(
Proceeds on sale of assets, net	500	
Purchase of short term investments	(5,280,000)	(2,
Maturity of short term investments	4,224,000	
Net cash used in investing activities	(5,750,964)	(2,
Cash Flows From Financing Activities:		
Sale of treasury stock	4,396,423	
Dividends on common stock	(505,631)	(
Purchase of treasury stock	(679,808)	(
Proceeds from exercise of stock options	153,055	
Net cash provided by (used in) financing activities	3,364,039	(
Decrease in cash and cash equivalents	(2,076,283)	(2,
Cash and cash equivalents, beginning of period	9,803,507	12,
Cash and cash equivalents, end of period	7,727,224	10,

Supplemental disclosures of cash flow information:		
Income Taxes Paid	$ 591,345	$

Non-cash investing and financing activities:
During the period ended December 31, 2005, the Company effected a stock split in the form of a stock dividend of 1,514,937 common shares, representing one share for each share outstanding and each share held as a treasury share. This resulted in a transfer from retained earnings to common stock of $504,979.

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 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.

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005	Nine Months Ended March 31, 2006	Nine Months Ended March 31, 2005
Net income as reported	$ 365,057	$ 111,987	$ 857,061	$ 339,603
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(20,926)	(8,286)	(46,710)	(26,660)
Pro forma net income	$ 344,131	$ 103,701	$ 810,351	$ 312,943
Net Income per share:				
Basic-as reported	$ .18	$ .06	$ .43	$ .17
Basic-pro forma	$ .17	$ .05	$ .40	$ .15
Diluted-as reported	$ .18	$ .05	$ .42	$ .17
Diluted-pro forma	$ .17	$ .05	$ .40	$ .15

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 $246,625 at March 31, 2006. 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 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 against it.

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 (see note 3).

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 in 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 above ESOP information has not been adjusted for the stock split described in note 7.

The Board of Directors of the Company had 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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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

$104,948 for the quarter ended March 31, 2006 and $332,248 for the nine-month period ending March 31, 2006. The ESOP shares as of March 31 (after the stock split described in note 7) were as follows:

Allocated Shares	420,585
Committed-to-be-released shares	19,374
Unreleased shares	280,626
Total shares held by the ESOP	720,585
Fair value of unreleased shares at March 31, 2006	$4,447,922

Note 7. Stock Split

On December 30, 2005, the Company effected a one-for-one stock split in the form of a dividend of one share of common stock for each share of common stock outstanding. The Company also allocated to treasury an additional share for each share being held as a treasury share. All references to the number of common shares, shares related to the Company's stock option plan, as well as per share data in the accompanying financial statements, have been adjusted to reflect the stock split on a retroactive basis with the exception of the details describing the Company's ESOP transaction which became executed on July 15, 2005 described in note 6 and "Other Matters". As a result of the stock split, common stock was increased and retained earnings was decreased by $504,979.

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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 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.

Management is optimistic about the future of the Company. In the first nine months of fiscal 2006, the Company received approximately $23.7 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 being involved in long-term high quantity military and industrial products.

The sales backlog of approximately $41.2 million at March 31, 2006 gives the Company a solid base of future sales and, therefore, management expects an increase in sales for fiscal 2006 as compared to fiscal 2005. In addition to the backlog, the Company currently has outstanding quotations representing approximately $21.2 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 $41.2 million at March 31, 2006, up $26.9 million over March 31, 2005, represents the estimated remaining sales value of work to be performed under firm contracts. The funded portion of this backlog at March 31, 2006 is approximately $32.9 million. This includes items that have been authorized and appropriated by Congress and/or funded by the customer. The unfunded backlog is approximately $8.3 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 March 31, 2005 was zero. The backlog at March 31, 2006 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.

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 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 March 31, 2006 were $4,677,808 as compared to $4,219,861 for the same period in 2005, representing a 10.9% increase. Net sales for the nine months ended March 31, 2006 were $14,294,465 as compared to $13,846,929 for the same period in 2005, representing a 3.2% increase. Generally, this increase can be attributed to the contract specific nature of the Company's business and the long-term nature of these contracts. The increase in backlog that occurred during the last two quarters of fiscal 2005 began to be recognized in net sales. This trend is expected to continue into the next several quarters. New orders received in the first nine months of fiscal 2006 were approximately $23.7 million compared to approximately $12.7 million in the first nine months 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 March 31, 2006 and 2005 gross profits were $1,042,265 and $650,890, respectively. Gross profit as a percentage of sales was 22.3% and 15.4%, for the three months ended March 31, 2006 and 2005, respectively. For the nine months ended March 31, 2006 and 2005 gross profits were $2,869,915 and $2,072,419, respectively. Gross profit as a percentage of sales was 20.1% and 15.0%, for the nine months ended March 31, 2006 and 2005, respectively. The improved gross profit percentage in the three and nine months ended March 31, 2006, relates to favorable product mix, offset partially by higher ESOP contribution expense and higher energy costs. ESOP contribution expense included in cost of sales was $83,958 for the three months ended March 31, 2006, and $265,799 for the nine months ended March 31, 2006, and $0 for both comparable periods of the prior year (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 March 31, 2006 was 173 people compared to 171 people at March 31, 2005.

Selling, general and administrative expenses were $649,101 for the three months ended March 31, 2006; an increase of $83,956 compared to the three months ended March 31, 2005. Selling, general and administrative expenses were $1,985,260 for the nine months ended March 31, 2006; an increase of $238,898 compared to the nine months ended

March 31, 2005. The increase is primarily due to an increase in the sales force and ESOP contribution expense, offset partially by a decrease in professional fees.

Other income for three and nine months ended March 31, 2006 increased as compared to the three and nine months ended March 31, 2005 due to increased interest income on the Company's cash and cash equivalents and short-term investments due to higher interest rates. The Company does not believe that there is a significant risk associated with its investment policy, since at March 31, 2006 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 March 31, 2006 and 2005 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 March 31, 2006, was $365,057 or $.18 per share, both basic and diluted, respectively, compared to $111,987 or $.06 and $.05 per share, basic and diluted, for the three months ended March 31, 2005. Net income for the nine months ended March 31, 2006, was $857,061 or $.43 and $.42 per share, basic and diluted, compared to $339,603 or $.17 per share, both basic and diluted, for the nine months ended March 31, 2005. The increase in net income per share was due to improved gross profit as a percentage of sales, offset partially by the 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 March 31, 2006 was approximately $25.3 million. During the three months ended March 31, 2006 and 2005 the Company repurchased 0 and 9,420 shares, respectively, of its common stock from the Company's Employee Retirement Plan and Trust ("ESOP"), for a total purchase price of $0 and $125,051, respectively. During the nine months ended March 31, 2006 and 2005 the Company repurchased 38,746 and 17,448 shares, respectively, of its common stock for a total purchase price of $679,808 and $215,366, respectively. Under existing authorizations from the Company's Board of Directors, as of March 31, 2006, management is authorized to purchase an additional $737,876 of Company stock.

Nine Months Ended March 31,

	2006	2005
Net cash provided by operating activities	$ 310,642	$ 516,028
Net cash used in investing activities	(5,750,964)	(2,012,305)
Net cash provided by (used in) financing activities	3,364,039	(654,908)

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 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 half of fiscal 2006.

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, 2006 and 2005, the Company expended $360,464 and $380,305, 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 $246,620 at March 31, 2006. The Company does not expect to fund any of the amounts under the standby letters of credit.

Other Matters

On July 15, 2005, pursuant to a Stock Purchase Agreement dated as of such date, 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 above ESOP information has not been adjusted for the stock split described in note 7.

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. As of March 31, 2006, there were 420,585 shares (after giving effect to the one-for-one stock dividend) allocated to participants.

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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 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 periods ended March 31, 2006, 1,000 and 16,400 stock options were exercised under the Company's existing stock option plan, respectively. In addition to the stock option shares, the Company sold 3,520 shares to the ESOP for the three and nine-month periods ended March 31, 2006. 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 Appr Dollar V of Sha that Ma Be Purc Under th or Progr
March 1 to March 31, 2006	--	--	--	$737,

(1) Pursuant to a prior Board of Directors authorization, as of March 31, 2006 the Company can repurchase up to $737,876 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

None

Item 5. Other Information

None

Item 6. Exhibits

(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

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

May 08, 2006

Date