ESPEY MFG & ELECTRONICS CORP
Form 10-Q
May 12, 2016

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 March 31, 2016

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)

518-245-4400

(Registrant's telephone number, including area code)

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

S Yes £ No

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

S Yes £ No

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

£ Large accelerated filer	£ Non-accelerated filer
£ Accelerated file	S Smaller reporting company

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

£ Yes S No

At May 11, 2016, there were 2,364,684 shares outstanding of the registrant's Common stock, $.33-1/3 par value.

ESPEY MFG. & ELECTRONICS CORP.

Quarterly Report on Form 10-Q

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PART I: FINANCIAL INFORMATION

ESPEY MFG. & ELECTRONICS CORP.

Balance Sheets

March 31, 2016 (Unaudited) and June 30, 2015

	March 31, 2016	June 30, 2015
ASSETS:		
Cash and cash equivalents	$ 9,547,801	$ 8,859,405
Investment securities	5,393,116	4,159,057
Trade accounts receivable, net of allowance of $3,000	4,852,417	6,694,401
Income taxes receivable	172,459	—
Inventories:		
Raw materials	1,369,959	1,481,792
Work-in-process	638,271	561,682
Costs relating to contracts in process, net of advance payments of $18,313 at March 31, 2016 and $19,626 at June 30, 2015	9,392,537	9,542,423
Total inventories	11,400,767	11,585,897
Deferred income taxes	214,534	334,681
Prepaid expenses and other current assets	260,765	211,940
Total current assets	31,841,859	31,845,381
Property, plant and equipment, net	2,314,311	2,498,863
Total assets	$ 34,156,170	$ 34,344,244
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Accounts payable	$ 672,517	$ 976,112
Accrued expenses:		
Salaries and wages	306,277	332,387
Vacation	733,106	690,833
ESOP payable	254,865	—
Dividend payable	—	590,672
Other	301,779	548,817
Payroll and other taxes withheld	50,855	47,082
Income taxes payable	—	2,716
Total current liabilities	2,319,399	3,188,619
Deferred tax liability	157,444	224,751
Total liabilities	2,476,843	3,413,370
Commitments and contingencies (see Note 5)		
Common stock, par value $.33-1/3 per share. Authorized 10,000,000 shares; Issued 3,029,874 shares on March 31, 2016 and June 30, 2015. Outstanding 2,361,084 and 2,362,687 on March 31, 2016 and June 30, 2015, respectively (includes 66,042 and 79,167 Unearned ESOP shares, respectively)	1,009,958	1,009,958
Capital in excess of par value	17,003,266	16,785,604

Accumulated other comprehensive income (loss)	845	(4,386)
Retained earnings	22,642,154	21,865,951
	40,656,223	39,657,127
Less: Unearned ESOP shares	(1,143,957)	(1,143,957)
Treasury shares, cost of 668,790 and 667,187 shares on March 31, 2016 and June 30, 2015, respectively	(7,832,939)	(7,582,296)
Total stockholders' equity	31,679,327	30,930,874
Total liabilities and stockholders' equity	$ 34,156,170	$ 34,344,244

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.

Statements of Comprehensive Income (Unaudited)

Three and Nine Months Ended March 31, 2016 and 2015

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2016	2015	2016	2015
Net sales	$7,217,922	$6,470,286	$20,739,378	$17,860,841
Cost of sales	5,069,699	5,032,752	15,034,792	12,354,493
Gross profit	2,148,223	1,437,534	5,704,586	5,506,348
Selling, general and administrative expenses	781,248	765,900	2,285,856	1,997,279
Operating income	1,366,975	671,634	3,418,730	3,509,069
Other income				
Interest income	4,240	9,362	22,303	26,416
Other	12,712	5,024	57,263	25,618
Total other income	16,952	14,386	79,566	52,034
Income before income taxes	1,383,927	686,020	3,498,296	3,561,103
Provision for income taxes	411,459	179,651	1,032,871	924,431
Net income	$972,468	$506,369	$2,465,425	$2,636,672
Other comprehensive income, net of tax:				
Unrealized gain (loss) on investment securities	4,357	(259)	5,231	(1,672)
Total comprehensive income	$976,825	$506,110	$2,470,656	$2,635,000
Net income per share:				
Basic	$0.43	$0.22	$1.08	$1.16
Diluted	$0.43	$0.22	$1.08	$1.15
Weighted average number of shares outstanding:				
Basic	2,259,529	2,271,105	2,273,401	2,269,157
Diluted	2,274,781	2,297,071	2,290,927	2,286,312
Dividends per share:	$0.25	$0.25	$0.75	$0.75

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.

Statements of Cash Flows (Unaudited)

Nine Months Ended March 31, 2016 and 2015

	March 31, 2016	March 31, 2015
Cash Flows from Operating Activities:		
Net income	$2,465,425	$2,636,672
Adjustments to reconcile net income to net cash provided by operating activities:		
Excess tax benefits from share-based compensation	(15,021)	(26,835)
Stock-based compensation	74,533	42,051
Depreciation	324,745	336,403
ESOP compensation expense	334,031	333,389
Loss on disposal of assets	147	233
Deferred income tax expense	55,656	63,715
Changes in assets and liabilities:		
Decrease (increase) in trade receivable, net	1,841,984	(984,778)
(Increase) decrease in income taxes receivable	(172,459)	774,880
Decrease (increase) in inventories, net	185,130	(2,172,380)
Increase in prepaid expenses and other current assets	(48,825)	(67,950)
(Decrease) increase in accounts payable	(303,595)	959,648
Decrease in accrued salaries and wages	(26,110)	(104,707)
Increase (decrease) in vacation accrual	42,273	(48,633)
Decrease in ESOP payable	(79,166)	(73,125)
Decrease in other accrued expenses	(247,038)	(437,007)
Increase (decrease) in payroll and other taxes withheld	3,773	(1,010)
Increase in income taxes payable	12,305	26,835
Net cash provided by operating activities	4,447,788	1,257,401
Cash Flows from Investing Activities:		
Additions to property, plant and equipment	(140,340)	(162,822)
Purchase of investment securities	(3,575,584)	(2,599,572)
Proceeds from sale/maturity of investment securities	2,343,942	3,262,397
Net cash (used in) provided by investing activities	(1,371,982)	500,003
Cash Flows from Financing Activities:		
Dividends on common stock	(2,279,895)	(1,698,306)
Purchase of treasury stock	(355,418)	(320,504)
Proceeds from exercise of stock options	232,882	115,556
Excess tax benefits from share-based compensation	15,021	26,835
Net cash used in financing activities	(2,387,410)	(1,876,419)
Increase in cash and cash equivalents	688,396	(119,015)

Cash and cash equivalents, beginning of period	8,859,405	9,556,891
Cash and cash equivalents, end of period	$9,547,801	$9,437,876
Supplemental Schedule of Cash Flow Information:		
Income taxes paid	$1,143,000	$59,000

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.

Notes to Financial Statements (Unaudited)

Note 1. Basis of Presentation

In the opinion of management the accompanying unaudited financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the results for such periods. The results for any interim period are not necessarily indicative of the results to be expected for the full fiscal year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles have been condensed or omitted. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of assets and liabilities. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, inventories, income taxes, and stock-based compensation. Management bases its estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. These financial statements should be read in conjunction with the Company's most recent audited financial statements included in its report on Form 10-K for the year ended June 30, 2015. Certain reclassifications may have been made to the prior year financial statements to conform to the current year presentation.

Note 2. Fair Value of Financial Instruments and Investments

ASC 820 establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.
- Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3: Significant unobservable inputs that reflect a reporting entity’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The carrying amounts of financial instruments, including cash and cash equivalents, short term investments, accounts receivable, accounts payable and accrued expenses, approximated fair value as of March 31, 2016 and June 30, 2015, because of the immediate or short-term maturity of these financial instruments.

Investment securities at March 31, 2016 and June 30, 2015, consist of certificates of deposit and municipal bonds which are classified as available-for-sale securities and have been determined to be level 1 assets. The cost, gross unrealized gains, gross unrealized losses and fair value of available-for-sale securities by major security type at March 31, 2016 and June 30, 2015, are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2016				
Certificates of deposit	$4,663,000	$ —	$ —	$4,663,000

Municipal bonds	728,816	1,300	—	730,116
Total investment securities	$5,391,816	$ 1,300	$ —	$5,393,116
June 30, 2015				
Certificates of deposit	$3,272,000	$ —	$ —	$3,272,000
Municipal bonds	893,804	1,288	(8,035)	887,057
Total investment securities	$4,165,804	$ 1,288	$ (8,035)	$4,159,057

The portfolio is diversified and highly liquid and primarily consists of investment grade fixed income instruments. At March 31, 2016, the Company did not have any investments in individual securities that have been in a continuous loss position considered to be other than temporary.

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As of March 31, 2016 and June 30, 2015, the contractual maturities of available-for-sale securities were as follows:

	Years to Maturity		
	Less than One Year	One to Five Years	Total
March 31, 2016			
Available-for-sale	$5,043,116	$ 350,000	$5,393,116
June 30, 2015			
Available-for-sale	$3,522,728	$ 636,329	$4,159,057

Note 3. 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. The computation of weighted-average common shares outstanding, assuming dilution, excluded options to purchase 92,400 and 25,250 shares of our common stock for the nine months ended March 31, 2016 and March 31, 2015, respectively, as the effect of including them would be anti-dilutive. As Unearned ESOP shares are released or committed-to-be-released the shares become outstanding for earnings-per-share computations.

Note 4. Stock Based Compensation

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

Total stock-based compensation expense recognized in the statements of comprehensive income for the three-month period ended March 31, 2016 and 2015, was $22,284 and $15,993, respectively, before income taxes. The related total deferred tax benefit was approximately $1,765 and $1,371 for the same periods. Total stock-based compensation expense recognized in the statements of comprehensive income for the nine-month period ended March 31, 2016 and 2015, was $74,533 and $42,051, respectively, before income taxes. The related total deferred tax benefit was approximately $6,206 and $4,113 for the same periods. ASC 718 requires the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options to be classified and reported as both an operating cash outflow and a financing cash inflow.

As of March 31, 2016, there was approximately $103,223 of unrecognized compensation cost related to stock option awards that is expected to be recognized as expense over the next 2 years. The total deferred tax benefit related to these awards is approximately $8,530.

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 Directors and employees of the Company at the fair market value of the common stock on the date of grant. Generally, options granted have a two-year vesting period based on two years of continuous service and have a ten-year contractual life. Option grants provide for accelerated vesting if there is a change in control. Shares issued

upon the exercise of options are from those held in Treasury. The 2007 Plan was approved by the Company's shareholders at the Company's Annual Meeting on November 30, 2007 and supersedes the Company's 2000 Stock Option Plan (the "2000 Plan"). Options covering 400,000 shares were authorized for issuance under the 2007 Plan, of which 235,650 have been granted and 162,250 are outstanding as of March 31, 2016. While no further grants of options may be made under the 2000 Plan, as of March 31, 2016, 10,800 options remain outstanding, vested and exercisable from the 2000 Plan.

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

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The table below outlines the weighted average assumptions that the Company used to calculate the fair value of the option award for the nine months ended March 31, 2016 and 2015.

	March 31, 2016	March 31, 2015
Dividend yield	3.85%	3.77%
Expected stock price volatility	28.09%	29.11%
Risk-free interest rate	1.33%	0.99%
Expected option life (in years)	4.1 yrs	4.0 yrs
Weighted average fair value per share of options granted during the period	$ 4.149	$ 4.296

The Company pays dividends quarterly and paid cash dividends totaling $0.75 per share for the nine months ended March 31, 2016 and 2015. Our Board of Directors assesses the Company's dividend policy periodically. There is no assurance, that the Board of Directors will either maintain the amount of the regular cash dividend or declare a special dividend during any future years. Expected stock price volatility is based on the historical volatility of the Company's stock. The risk-free interest rate is based on the implied yield available on U.S. Treasury issues with an equivalent term approximating the expected life of the options. The expected option life (in years) represents the estimated period of time until exercise and is based on actual historical experience.

The following table summarizes stock option activity during the nine months ended March 31, 2016:

	Employee Stock Options Plan			
	Number of Shares Subject To Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at July 1, 2015	187,500	$ 23.38	6.26	
Granted	1,500	$ 26.03	9.82	
Exercised	(12,700)	$ 18.34	—	
Forfeited or expired	(3,250)	$ 25.99	—	
Outstanding at March 31, 2016	173,050	$ 23.72	5.83	$311,241
Vested or expected to vest at March 31, 2016	166,673	$ 23.62	5.70	$311,241
Exercisable at March 31, 2016	128,750	$ 22.87	4.69	$311,241

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the closing sale price of the Company's common stock as reported on the NYSE MKT on March 31, 2016, and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders if all option holders had exercised their options on March 31, 2016. This amount changes based on the fair market value of the Company's common stock. The total intrinsic values of the options exercised during the nine months ended March 31, 2016 and 2015, was $36,374 and $53,242, respectively.

The following table summarizes changes in non-vested stock options during the nine months ended March 31, 2016:

	Weighted Number of Shares Subject to Option	Average Grant Date Fair Value (per Option)
Non-Vested at July 1, 2015	69,300	$ 4.310
Granted	1,500	$ 4.149
Vested	(25,250)	$ 3.777
Forfeited or expired	(1,250)	$ 4.710
Non-Vested at March 31, 2016	44,300	$ 4.598

Note 5. Commitments and Contingencies

The Company at certain times enters into standby letters of credit agreements with financial institutions primarily relating to the guarantee of future performance on certain contracts. Contingent liabilities on outstanding standby letters of credit agreements aggregated to zero at March 31, 2016 and 2015. The Company, as a U.S. Government contractor, is subject to audits, reviews, and investigations by the U.S. government related to its negotiation and performance of government contracts and its accounting for such contracts. Failure to comply with applicable U.S. Government standards by a contractor may result in suspension from eligibility for award of any new government contract and a guilty plea or conviction may result in debarment from eligibility for awards. The government may, in certain cases, also terminate existing contracts, recover damages, and impose other sanctions and penalties.

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Note 6. Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers,” which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The standard is effective for annual periods beginning after December 15, 2017, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). Early adoption is permitted for annual periods beginning after December 15, 2016, and interim periods therein. We are currently evaluating the impact of our pending adoption of ASU 2014-09 on our financial statements and have not yet determined the method by which we will adopt the standard in fiscal 2019.

In July 2015, the FASB issued ASU No. 2015-11, “Inventory (Topic 330): Simplifying the Measurement of Inventory”. ASU 2015-11 requires inventory measured using any method other than last-in, first out or the retail inventory method to be subsequently measured at the lower of cost and net realizable value, rather than at the lower of cost or market. Net realizable value is defined as the estimated selling price, less the estimated costs to complete, dispose, and transport such inventory. ASU No. 2015-11 will be effective for fiscal years and interim periods beginning after December 15, 2016. ASU No. 2015-11 is required to be applied prospectively and early adoption is permitted. The Company’s adoption of ASU No. 2015-11 is not expected to have a material impact on the Company’s financial position or results of operations.

In November 2015, the FASB issued ASU 2015-17, “Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes”. The guidance requires the classification of deferred tax assets and liabilities as non-current in a classified balance sheet. The current requirement that deferred tax assets and liabilities of a tax-paying component of an entity be offset and presented as a single amount is not affected by this update. ASU No. 2015-17 will be effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. ASU No. 2015-17 may be applied prospectively or retrospectively, and early adoption is permitted. Adoption of ASU 2015-17 would have the following impact on the Company’s financial statements at March 31, 2016; a decrease in current assets of $214,534, a decrease in non-current liabilities of $157,444 and an increase in non-current assets of $57,090.

In January 2016, the FASB issued ASU No. 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities”. The amendments in this Update address certain aspects of recognition, measurement, presentation and disclosure of financial instruments in order to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. ASU No. 2016-01 will be effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. The Company is evaluating the impact that ASU 2016-01 will have on the Company's financial statements.

In March 2016, the FASB issued ASU No. 2016-08, “Revenue from Contracts with Customers – Principal versus Agent Considerations (Reporting Revenue Gross versus Net)”. ASU 2016-08 provides guidance on principal versus agent considerations by an entity as discussed in ASU 2014-09, issued May 2014. ASU 2016-08 provides criteria to be

assessed by an entity when determining whether it is the principal or agent in relation to the goods or services which the company is contractually obligated to provide to the customer. Among these considerations are; Identifying the unit of account at which the entity should assess whether it is a principal or an agent, Identifying the nature of the good or service provided to the customer; Applying the control principle to certain types of transactions; and, Interaction of the control principle with the indicators provided to assist in the principle versus agent evaluation. The effective date and transition requirements for the amendments in this Update are consistent with the effective date and transition requirements of Update 2014-09. The Company’s adoption of ASU 2016-08 is not expected to have a material impact on the Company’s financial position or results of operations.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting”. The areas for simplification in this Update involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU No. 2016-09 will be effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. ASU No. 2016-09 may be applied prospectively or retrospectively, and early adoption is permitted. The Company is evaluating the impact that ASU 2016-09 will have on the Company's financial statements.

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Note 7. Employee Stock Ownership Plan

The Company sponsors a leveraged employee stock ownership plan (the "ESOP") that covers all nonunion employees who work 1,000 or more hours per year and are employed on June 30. The Company makes annual contributions to the ESOP equal to the ESOP's debt service less dividends on unallocated shares received by the ESOP. All dividends on unallocated shares received by the ESOP are used to pay debt service. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings. As the debt is repaid, shares are released and allocated to active employees, based on the proportion of debt service paid in the year. The Company accounts for its ESOP in accordance with FASB ASC 718-40. Accordingly, the shares purchased by the ESOP are reported as Unearned ESOP Shares in the statement of financial position. As shares are released or committed-to-be-released, the Company reports compensation expense equal to the current average market price of the shares, and the shares become outstanding for earnings-per-share (EPS) computations. ESOP compensation expense was $109,856 and $124,712 for the three-month periods ended March 31, 2016 and 2015, respectively. ESOP compensation expense was $334,031 and $333,389 for the nine-month periods ended March 31, 2016 and 2015, respectively.

The ESOP shares as of March 31, 2016 and 2015, were as follows:

	March 31, 2016	March 31, 2015
Allocated Shares	423,568	441,531
Committed-to-be-released shares	13,125	13,750
Unreleased shares	66,042	83,750
Total shares held by the ESOP	502,735	539,031
Fair value of unreleased shares	$ 1,624,633	$ 2,480,675

During the three and nine months ended March 31, 2016, the Company repurchased 0 and 14,303 shares previously held in the ESOP for $0 and $355,418, respectively. During the three and nine months ended March 31, 2015, the Company repurchased 0 and 13,553 shares previously held in the ESOP for $0 and $320,504, respectively.

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

Overview

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

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

Espey is ISO 9001:2008 and AS9100:2009 certified. Our primary products are power supplies, power converters, filters, power transformers, magnetic components, power distribution equipment, UPS systems, antennas and high power radar systems. The applications of these products include AC and DC locomotives, shipboard power, shipboard radar, airborne power, ground-based radar, and ground mobile power.

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

The Company markets its products primarily through its own direct sales organization and through outside sales representatives. 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. Espey is also on the eligible list of contractors with the United States Department of Defense and generally is automatically solicited by Defense Department procurement agencies for their needs falling within the major classes of products produced by the Company. In addition, the Company directly pursues opportunities from the United States Department of Defense for prime contracts. Espey contracts with the Federal Government under cage code 20950 as Espey Mfg. & Electronics Corp.

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.

Our business is not seasonal. However, the concentration of our business in equipment for industrial and military applications and our customer concentrations expose us to on-going associated risks including, without limitation, dependence on appropriations from the United States Government and the governments of foreign nations, program allocations of a single customer, and the potential of governmental termination of orders for convenience.

Uncertainty in federal defense spending and competition in our industrial customer base continues to be a concern. Based upon discussions during contract negotiations with our major customers over the past several years, we believe that many of our competitors have been aggressively investing in upfront product design costs and lowering profit margins as a strategic means of maintaining existing business and enhancing market share at the expense of short term profit. This change in the market place has put pressure on the pricing of our current products and will result in lower margins on new business and some of our legacy business. In order to compete effectively for new business, in some cases we invest in upfront design costs, thereby reducing initial profitability as a means of procuring new long-term programs. Accordingly, we have adjusted our pricing strategy in order to achieve a balance which enables us both to retain repeat programs while being more competitive in bidding on new programs.

The Company's backlog was approximately $41.6 million at March 31, 2016, which includes $26.2 million from two significant customers, compared to $38.4 million at March 31, 2015, which included $24.4 million from two significant customers. The backlog at March 31, 2016, also includes a $10.1 million delivery order attributable to an award of a significant contract from the Federal Government. Revenues under this contract are not expected to be realized until fiscal year 2017. The backlog for the Company represents the estimated remaining sales value of work to be performed under firm contracts. This includes items that have been authorized and appropriated by Congress and/or funded by the customer. The unfunded portions of the backlog at March 31, 2016 and 2015, were $0 and $2.3 million, respectively, representing firm multi-year orders for which funding had not yet been appropriated by Congress or funded by our customer. 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 based on discussions with customers and program status.

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Management expects revenues in fiscal year 2016 to increase as compared with fiscal year 2015 revenues. Current expectations are for gross margins to be lower compared to prior year due to product mix, competitive pricing pressures, new program investments, and a one-time reduction to cost of sales in the prior year discussed within the Results of Operations, below. New orders received in the first nine months of fiscal 2016 were approximately $26.0 million as compared to $20.5 million of new orders received in the first nine months of fiscal 2015. It is presently anticipated that a minimum of $6 million of orders comprising the March 31, 2016, backlog will be filled during the fiscal year ending June 30, 2016. The minimum of $6 million does not include any shipments, which may be made against orders subsequently received during the fiscal year ending June 30, 2016.

In addition to the backlog, the Company currently has outstanding opportunities representing in excess of $51 million in the aggregate as of May 11, 2016, for both repeat and new programs. 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 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 industrial locomotive power supply procurement of a single customer.

Management continues to evaluate our sales strategy including the professional and technical resources necessary to keep pace with the changing market conditions and needs of our customers. The Company has added to and re-aligned current sales and engineering resources, in order to focus on penetrating opportunities with new and existing customers. The Company continues quoting current and new customers for programs of varying sizes.

Net sales to four significant customers represented 68.6% of the Company's total sales for the three-month period ended March 31, 2016, and net sales to two significant customers represented 63.8% of the Company’s total sales for the three-month period ended March 31, 2015. Net sales to two significant customers represented 49.5% of the Company's total sales for the nine-month period ended March 31, 2016, and net sales to three significant customers represented 59.5% of the Company’s total sales for the nine-month period ended March 31, 2015. This high concentration level with these customers presents significant risk. A loss of one of these customers or programs related to these customers could significantly impact the Company. Historically, a small number of customers have accounted for a large percentage of the Company’s total sales in any given fiscal year. Management continues to pursue opportunities with current and new customers with an overall objective of lowering the concentration of sales and mitigating excessive reliance upon a single major product of a particular program or minimizing the impact of the loss of a single significant customer.

Critical Accounting Policies and Estimates

Management believes our most critical accounting policies include revenue recognition and cost 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 increased for the three months ended March 31, 2016, to $7,217,922 as compared to $6,470,286 for the same period in 2015. Net sales for the nine months ended March 31, 2016, increased to $20,739,378 as compared to $17,860,841 for the same period in 2015. For the three months ended March 31, 2016, the increase in net sales is primarily due to increased magnetics shipments offset by a decrease in power supplies shipped. For the nine months ended March 31, 2016, the increase in net sales is primarily due to increased shipments of magnetics and power supplies, offset by a decline in spare part sales.

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For the three months ended March 31, 2016 and 2015, gross profits were $2,148,223 and $1,437,534, respectively. Gross profit as a percentage of sales was 29.8% and 22.2%, for the three months ended March 31, 2016 and 2015, respectively. For the nine months ended March 31, 2016 and 2015, gross profits were $5,704,586 and $5,506,348, respectively. Gross profit as a percentage of sales was 27.5% and 30.8%, for the nine months ended March 31, 2016 and 2015, respectively. The primary factors in determining gross profit and net income are overall sales levels and product mix. The gross profits on mature products and build to print contracts are higher as compared to products which are still in the engineering development stage or in early stages of production. In the case of the latter, the Company incurs what it refers to as “loss contracts,” meaning engineering design contracts in which the Company invests with the objective of developing future product sales. In any given accounting period the mix of product shipments between higher margin programs and less mature programs, and expenditures associated with loss contracts, has a significant impact on gross profit and net income. The gross profit percentage increased in the three months ended March 31, 2016, as compared to the same period ended March 31, 2015 due to the impact of higher margins resulting from product mix. The gross profit percentage decreased for the nine months ended March 31, 2016, as compared to the nine months ended March 31, 2015 due to a favorable one-time reduction to cost of sales that occurred during the nine months ended March 31, 2015. The prior year reduction totaled $560,000 for a contract settlement related to a previously cancelled program.

Selling, general and administrative expenses were $781,248 for the three months ended March 31, 2016; an increase of $15,348, compared to the three months ended March 31, 2015. Selling, general and administrative expenses were $2,285,856 for the nine months ended March 31, 2016; an increase of $288,577 compared to the nine months ended March 31, 2015. The increase for the three and nine months ended March 31, 2015 relates primarily to an increase in compensation costs due to pay increases and an increase in the number of employees.

Other income for the three months ended March 31, 2016 and 2015, was $16,952 and $14,386, respectively. Other income for the nine months ended March 31, 2016 and 2015, was $79,566 and $52,034, respectively. The increase is primarily due to an increase in scrap metal sales.

The Company’s effective tax rates for the three and nine months ended March 31, 2016, were 29.7% and 29.5%, respectively, compared to 26.2% and 26.0% for the three and nine months ended March 31, 2015, respectively. The effective tax rate is less than the statutory tax rate mainly due to the benefit the Company receives on its “qualified production activities” under The American Jobs Creation Act of 2004 and the benefit derived from the ESOP dividends paid on allocated shares. The increase in the effective tax rate for March 31, 2016, is primarily due to a reduced benefit caused by the reduction in dividends deductible for income tax purposes.

Net income for the three months ended March 31, 2016, was $972,468 or $0.43 per share both basic and diluted, respectively compared to $506,369 or $0.22 per share both basic and diluted, for the three months ended March 31, 2015. Net income for the nine months ended March 31, 2016, was $2,465,425 or $1.08 per share both basic and diluted compared to $2,636,672 or $1.16 and $1.15 per share, basic and diluted, respectively, for the nine months ended March 31, 2015. The increase in net income per share for the three months ended March 31, 2016, was primarily due to higher sales and higher margins resulting from product mix. The decrease in net income per share for the nine months ended March 31, 2016, was mainly due to higher selling, general and administrative expenses and a higher effective income tax rate offset by an increase in sales. Also, impacting the comparison is a prior year favorable one-time $560,000 reduction to cost of sales referred to above.

Liquidity and Capital Resources

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

the last two fiscal years. Management has available a $3,000,000 line of credit to help fund further growth or working capital and letter of credit needs, if necessary, but does not anticipate the need for any borrowed funds in the foreseeable future. Contingent liabilities on outstanding standby letters of credit agreements aggregated to zero at March 31, 2016 and 2015.

The Company's working capital as of March 31, 2016 and 2015, was approximately $29.5 million and $28.1 million, respectively. During the three and nine months ended March 31, 2016, the Company repurchased 0 and 14,303 shares of its common stock from the Company’s Employee Retirement Plan and Trust (”ESOP”) for a purchased price of $0 and $355,418, respectively. During the three and nine months ended March 31, 2015 the Company repurchased 0 and 13,553 shares of its common stock, respectively, from the ESOP for a purchase price of $0 and $320,504, respectively. Under existing authorizations from the Company’s Board of Directors, as of March 31, 2016, management is authorized to purchase an additional $1,030,326 of Company Stock.

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The table below presents the summary of cash flow information for the periods indicated:

	Nine Months Ended March 31,	
	2016	2015
Net cash provided by operating activities	$ 4,447,788	$ 1,257,401
Net cash (used in) provided by investing activities	(1,371,982)	500,003
Net cash used in financing activities	(2,387,410)	(1,876,419)

Net cash provided by operating activities fluctuates between periods primarily as a result of differences in sales and net income, provisions for income taxes, the timing of the collection of accounts receivable, purchase of inventory, and payment of accounts payable. The increase in net cash provided by operating activities primarily relates to an increase in trade receivable collections and a decline in inventory purchases due to the timing of production jobs, offset by an increase in cash paid for both federal income tax deposits and payments to vendors. Net cash provided by investing activities decreased in the nine months of fiscal 2016 due to the timing and reinvestment of matured investment securities. The increase in cash used in financing activities is due primarily to the dividend payable at June 30, 2015, paid in the nine months ended March 31, 2016.

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, 2016 and 2015, the Company expended $140,340 and $162,822, respectively, for plant improvements and new equipment. The Company has budgeted approximately $250,000 for new equipment and plant improvements in fiscal 2016. Management anticipates that the funds required will be available from current operations.

Management also 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.

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

SECURITIES LITIGATION REFORM ACT OF 1995

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is a smaller reporting company as defined under Securities and Exchange Commission Rule 12b-2. Pursuant to the exemption available to smaller reporting company issuers under Item 305 of Regulation S-K,

quantitative and qualitative disclosures about market risk, the Company is not required to provide the information for this item.

Item 4. Controls and Procedures

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

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

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PART II: Other Information and Signatures

Item 1. Legal Proceedings
None

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

(a)	Securities Sold - 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 Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plan or Program (1)
				$1,030,326

(1) Pursuant to a prior Board of Directors authorization, as of March 31, 2016, the Company can repurchase up to $1,030,326 of its common stock pursuant to an ongoing plan.

Item 3 Defaults Upon Senior Securities
None

Item 4. Mine Safety Disclosures
Not applicable

Item 5. Other Information
None

Item 6. Exhibits

31.1	Certification of the Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Principal Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of the Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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S I G N A T U R E S

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

ESPEY MFG. & ELECTRONICS CORP.

/s/Patrick Enright Jr.
Patrick Enright Jr.
President and Chief Executive Officer

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

Date: May 12, 2016