ESPEY MFG & ELECTRONICS CORP
Form 10-Q
October 31, 2003

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 September 30, 2003

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)	(Zip Code)

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 (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 October 29, 2003
Common stock, $.33-1/3 par value	1,014,901 shares

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

ESPEY MFG. & ELECTRONICS CORP.

Consolidated Balance Sheets (Unaudited)

September 30, 2003 and June 30, 2003

A S S E T S

	2003 September 30	2003 June 30
CURRENT ASSETS:		
Cash and cash equivalents	$ 10,786,460	$ 10,996,483
Trade accounts receivable, net	3,848,681	3,470,895
Other receivables	5,497	11,638
Inventories:		
Raw materials and supplies	1,618,575	1,570,028
Work-in-process	3,343,417	3,020,081
Costs relating to contracts in process, net of advance payments of $3,384,257 at September 30, 2003		

and $ 3,314,816 at June 30, 2003	6,242,468	7,246,158
Total Inventories	11,204,460	11,836,267
deferred income taxes	90,443	88,643
Prepaid expenses and other current assets	96,534	124,508
Total Current Assets	26,032,075	26,528,434
PROPERTY, PLANT AND EQUIPMENT, NET	3,210,302	3,267,063
Total Assets	$ 29,242,377	$ 29,795,497

See accompanying notes to the consolidated financial statements.

(Continued)

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ESPEY MFG. & ELECTRONICS CORP.

Consolidated Balance Sheets (Unaudited), Continued

September 30,2003 and June 30, 2003

LIABILITIES AND STOCKHOLDERS' EQUITY

	2003 September 30	2003 June 30
CURRENT LIABILITIES:		
Accounts payable	$ 640,324	$ 647,597
Accrued expenses:		
Salaries, wages and commissions	95,347	88,287
Vacation	400,365	465,815

Employees' insurance costs	7,462	7,038
ESOP payable	134,413	--
Other	17,071	42,361
Payroll and other taxes withheld and accrued	43,838	38,425
Income taxes payable	198,324	350,232
Total Current Liabilities	1,537,144	1,639,755
DEFERRED INCOME TAXES	237,234	202,234
Total Liabilities	1,774,378	1,841,989
STOCKHOLDERS' EQUITY:		
Common stock, par value .33-1/3 per share. Authorized 10,000,000 shares; Issued 1,514,937 on September 30, 2003 and June 30, 2003, 1,012,714 outstanding on September 30, 2003 and 1,019,643 on June 30, 2003	504,979	504,979
Capital in excess of par value	10,444,281	10,459,278
Retained earnings	25,106,418	25,458,400
Less Common stock subscribed	(558,662)	(558,662)
Cost of 502,223 shares on September 30, 2003 and 495,294 on June 30, 2003 of common stock in treasury	(8,029,017)	(7,910,487)
Total Stockholders' Equity	27,467,999	27,953,508
Total Liabilities And Stockholders' Equity	$ 29,242,377	$ 29,795,497

See accompanying notes to the consolidated financial statements.

ESPEY MFG. & ELECTRONICS CORP.

Consolidated Statements of Income (Unaudited)

Three Months Ended September 30, 2003 and 2002

	Three Months 2003	2002
Net sales	$ 5,095,317	$ 4,491,359
Cost of sales	4,195,145	3,702,138
Gross profit	900,172	789,221
Selling, general and administrative expenses	549,803	429,307
Operating income	350,369	359,914
Other income		
Interest and dividend income	23,365	45,269
Other income	1,240	3,544
	24,605	48,813
Income before income taxes	374,974	408,727
Provision for income taxes	94,009	102,182
Net Income	$ 280,965	$ 306,545
Income per share:		
Basic and diluted income per share	$ .28	$ .30
Weighted average number of shares outstanding		
Basic	1,016,105	1,034,561
Diluted	1,018,805	1,037,460

See accompanying notes to the consolidated financial statements.

ESPEY MFG. & ELECTRONICS CORP.
Consolidated Statements of Cash Flows (Unaudited)
Three Months Ended September 30, 2003 and 2002

	September 30, 2003	September 30, 2002
Cash Flows From Operating Activities:		
Net income	$ 280,965	$ 306,545
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	122,901	121,808
Deferred income tax payable	33,200	--
Changes in assets and liabilities:		
Increase in receivables, net	(371,645)	(1,269,579)
Decrease in inventories	631,807	272,749
Decrease in prepaid expenses and other current assets	27,974	49,317
(Decrease)Increase in accounts payable	(7,273)	415,536
Increase in accrued salaries, wages and commissions	7,060	500
Increase in accrued employees' insurance costs	424	156
Decrease in other accrued expenses	(25,290)	(4,417)
Decrease in vacation accrual	(65,450)	(50,277)
Increase in payroll & other taxes withheld and accrued	5,413	3,370
(Decrease)Increase in income taxes payable	(151,908)	102,182
Increase in ESOP contribution payable	134,413	136,514
Net cash provided by operating activities	622,591	84,404
Cash Flows From Investing Activities:		
Additions to property, plant & equipment	(66,140)	(208,217)
Net cash used in investing activities	(66,140)	(208,217)
Cash Flows From Financing Activities:		
Dividends on common stock	(632,946)	(77,592)
Purchase of treasury stock	(170,093)	--
Proceeds from exercise of stock options	36,565	--
Net cash used in financing activities	(766,474)	(77,592)
Decrease in cash and cash equivalents	(210,023)	(201,405)
Cash and cash equivalents, beginning of period	10,996,483	9,192,961
Cash and cash equivalents, end of period	$10,786,460	$ 8,991,556
Income Taxes Paid	$ 216,501	$ --

See accompanying notes to the consolidated financial statements.

ESPEY MFG. & ELECTRONICS CORP.

Notes to Consolidated Financial Statements (Unaudited)

Note 1. Basis of Presentation

In the opinion of management the accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission and contain all adjustments, consisting of only normal, recurring adjustments, necessary for a fair presentation of results for such periods. The results for any interim period are not necessarily indicative of results for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been omitted. Certain amounts in previously issued consolidated financial statements were reclassified to conform to fiscal 2003 presentations. These consolidated financial statements should be read in conjunction with the financial statements and notes thereto for the year ended June 30, 2003.

Note 2. Earnings per Share

Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings 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.

Note 3. Employee Stock Ownership Plan

In fiscal 1989 the Company established an Employee Stock Ownership Plan (ESOP) for eligible non-union employees. The ESOP used the proceeds of a loan from the Company to purchase 316,224 shares of the Company's common stock for approximately $8.4 million and the Company contributed approximately $400,000 to the ESOP, which was used by the ESOP to purchase an additional 15,000 shares of the Company's common stock.

As of September 30, 2003 there were 223,833 shares allocated to participants.

Note 4. Other Comprehensive Income

Total comprehensive income consists of:

	Three Months Ended September 30, 2003	2002
Net income	$280,965	$306,545
Accumulated other comprehensive income:		
Unrealized (loss) gain on available for sale securities	--	(1,882)

Total comprehensive income	$280,965	$304,663
	========	========

Note 5. Stock Based Compensation

In December 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 148, Accounting for Stock Based Compensation. SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation and amends the disclosure requirements of SFAS No. 123, Accounting for Stock Based Compensation, to require more prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

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. Unearned compensation recognized for restricted stock awards is shown as a separate component of shareholders' equity and is amortized to expense over the vesting period of the stock award using the straight-line method. The Company adopted the disclosure requirements of SFAS No. 123 and SFAS No. 148, as required.

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

	3 Months Ended September 30 2003	3 Months Ended September 30 2002
Net income as reported	$ 280,965	$ 306,545
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(9,227)	(9,020)
	---------	---------
Pro forma net income	$ 271,738	$ 297,525
	=========	=========
Earnings per share:		
Basic-as reported	$ .28	$ .30
	=========	=========
Basic-pro forma	$ .27	$ .29
	=========	=========

Diluted-as reported	$ .28	$ .30
Diluted-pro forma	$ .27	$ .29

Note 6. Recently Issued Accounting Standards

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity. SFAS No. 150 requires issuers to classify as liabilities (or assets in some circumstances) three classes of freestanding financial instruments that embody obligations for the issuer. Generally, SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003 and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 did not have an impact on the Company's results of operations and financial condition.

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

Critical Accounting Policies and Estimates

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

Revenue recognition and cost estimation

A significant portion of our business is comprised of development and production contracts. Generally revenue 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.

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

Results of Operations

Net sales for the three months ended September 30, 2003 were $5,095,317 as compared to $4,491,359 for the same period in 2002. The $603,958 increase in net sales for the three-month period is mainly due to increased transmitter component shipments.

During the first quarter of fiscal 2004 gross profits as compared with the first quarter of fiscal 2003 remained relatively consistent at 17% of sales. The increase in gross profit to approximately $900,000 from approximately $789,000 was primarily due to the increase in net sales. Included in cost of sales and gross profit is a $453,000 loss on one contract due to significant unexpected costs. Given the current estimate to complete on this contract, management believes the entire amount of the loss has been recorded in current period. Management anticipates that it will be able to maintain or improve the gross profit percentage for fiscal 2004 based on current backlog of orders. Management continues to evaluate the Company's workforce to insure that production and overall execution of backlog orders and additional anticipated orders are successfully performed. Present employment is 193 people.

Selling, general and administrative expenses were $549,803 for the three months ended September 30, 2003, an increase of $120,496, as compared to the three months ended September 30, 2002. This increase was primarily due to an increase in professional fees and insurance costs.

Total other income for the three months ended September 30, 2003 decreased by $24,208, as compared to the three months ended September 30, 2002. The decrease is due to lower interest rates on the Company's money market accounts and the sale of investment securities which paid a higher interest rate in the prior year. The Company believes there is minimal risk associated with its investment policy, since its investments are primarily represented by money market accounts.

Net income for the three months ended September 30, 2003 was $280,965 or $.28 per share compared to $306,545 or $.30 per share for the corresponding period ended September 30, 2002. As discussed above, the increase in gross profit was offset by the increase in selling, general and administrative expense, thus causing a slight decrease in net income.

The Company continues to diversify its customer base and product offerings. The backlog of customer orders at September 30, 2003 was approximately $20,893,000 as compared to approximately $26,239,000 at September 30, 2002.

Liquidity and Capital Resources

As of September 30, 2003, the Company had working capital of $24.3 million compared to $24.7 million at June 30, 2003. The Company meets its short-term financing needs through cash from operations and when necessary, from its existing cash and cash equivalents.

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

	Three Months Ended September 30, 2003	2002
Net cash provided by operating activities	$ 622,591	$ 84,404
Net cash used in investing activities	$ (66,140)	$(208,217)
Net cash used in financing activities	$(766,474)	$ (77,592)

Net cash provided by operating activities fluctuates between periods primarily as a result of differences in the level of sales and related net income, the timing of the collection of accounts receivable, purchase of inventory, and payment of accounts payable. Net cash used in investing activities represents purchases of fixed assets. Net cash used in financing activities represents dividends on common stock including a special dividend of $.50 per share which was paid on September 30, 2003.

The Company currently believes that its current cash and cash equivalent balances and the cash generated from operations will be sufficient to meet its funding requirements for the next twelve months. Management has in place an uncommitted $3,000,000 line of credit to help fund further growth if needed. For the first quarter of fiscal 2004 capital expenditures were approximately $66,000.

Since the debt of the Company's ESOP is not to an outside party the Company has eliminated from the Consolidated Statements of Income the offsetting items of interest income and interest expenses relating to ESOP. The Company has also eliminated the offsetting accruals and receivables from the Consolidated Balance Sheets.

During the three months ended September 30, 2003 the Company repurchased 9,529 shares of its common stock for a cost of $170,093 and in 2002, the Company did not repurchase any of its common stock. Under existing Board authorization, as of September 30, 2003, $644,802 could be utilized to repurchase the Company's common stock.

CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

It should be noted that in this Management's Discussion and Analysis of Financial Condition and Results of Operations are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are made pursuant to the safe harbor provisions 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, as well as supply and manufacturing constraints 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 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.

ESPEY MFG. & ELECTRONICS CORP.
PART II: Other Information and Signatures

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

None during the quarter.

Item 5. Other Information

None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

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

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

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

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

(b) Reports on Form 8-K

Form 8-K filed September 16, 2003 announcing dismissal of PricewaterhouseCoopers LLP as the Company's independent accountants.

Form 8-K filed September 26, 2003 announcing engagement of KPMG LLP as the Company's independent accountants.

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

29 October 2003

Date