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ESPEY MFG & ELECTRONICS CORP

Form 10-K

September 08, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10 - K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the fiscal year ended June 30, 2009

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from to

Commission file number 1-4383

ESPEY MFG. & ELECTRONICS CORP.

(Exact name of registrant as specified in its charter)

NEW YORK

14-1387171

(State or other jurisdiction of incorporation or organization)

(IRS Employer Identification No.)

233 Ballston Avenue, Saratoga Springs, NY 12866

(Address of principal executive offices including Zip Code)

(Registrant's telephone number including area code) (518)245-4400

Securities registered pursuant to Section 12(b) of the Act:

Table with 2 columns: Title of each class, Name of each exchange on which registered. Rows include Common Stock \$ .33-1/3 par value and Common Stock Purchase Rights, both listed on NYSE - Amex.

Securities registered pursuant to Section 12 (g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

[ ] Yes [X] No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

[ ] Yes [X] No

Indicate by check mark whether the registrant (1) has filed all reports required to the 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.

[X] Yes [ ] No

Indicate by check mark if disclosure of delinquent filers pursuant to Item

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405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

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

Indicate by check mark whether the registrant is a shell company. [ ] Yes [X] No

The aggregate market value of the voting stock held by non-affiliates of the registrant was \$26,659,835 based upon the closing sale price of \$18.16 on the NYSE - Amex on December 31, 2008.

At September 8, 2009, there were 2,314,803 shares outstanding of the registrant's Common stock, \$.33-1/3 par value.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement relating to the 2009 Annual Meeting of Shareholders, to be filed with the Securities and Exchange Commission, are incorporated by reference in Part III, Items 10 through 14 on Form 10-K as indicated herein.

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### Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements that are based on management's expectations, estimates, projections and assumptions. Words such as "expects," "anticipates," "plans," "believes," "scheduled," "estimates" and variations of these words and similar expressions are intended to identify forward-looking statements. Forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, as amended. These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict. Therefore, actual future results and trends may differ materially from what is forecast in forward-looking statements due to a variety of factors, including, without limitation:

- o Changing priorities in the U.S. government's defense budget (including changes in priorities in response to terrorist threats or to improve homeland security);
- o Termination of government contracts due to unilateral government action;
- o Differences in anticipated and actual program performance, including the ability to perform under long-term fixed-price contracts within estimated costs, and performance issues with key suppliers and subcontractors;
- o Potential of changing prices for energy and raw materials.

All forward-looking statements speak only as of the date of this report or, in the case of any document incorporated by reference, the date of that document. All subsequent written and oral forward-looking statements attributable to the Company or any person acting on the Company's behalf are qualified by the cautionary statements in this section. The Company does not undertake any obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date of this report.

PART I

Item 1. Business

General

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 Company operates a one-segment business and was incorporated in 1928.

The electronic power supplies and components 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 artillery.

The Company's iron-core components include (i) transformers of the audio, power and pulse types, (ii) magnetic amplifiers and (iii) audio filters. The electronic system components manufactured by the Company include antenna systems and high power radar transmitters. These system components utilize the Company's own electronic power supplies, transformers and other iron-core components and mechanical assemblies.

In the fiscal years ended June 30, 2009 and 2008, the Company's total sales were \$27,241,635 and \$25,701,739, respectively. Sales to two customers accounted for 33% and 30% of total sales in 2009. Sales to two customers accounted for 31% and 25% of total sales in 2008.

Export sales in 2009 and 2008 were approximately \$4,691,000 and \$5,538,000, respectively.

Sources of Raw Materials

The Company has never experienced any significant delay or shortage with respect to the purchase of raw materials and components used in the manufacture of its products, and has at least two potential sources of supply for a majority of its raw materials. However, certain components used in our products are available from only a limited number of sources, and other components are only available from a single source. Despite the risk associated with limited or single source suppliers, the benefits of higher quality goods and timely delivery minimize and often limit any potential risk and can eliminate problems with part failures during production.

Sales Backlog

At September 8, 2009, the Company's backlog was approximately \$38.3 million. The total backlog at June 30, 2009 was approximately \$39.1 million compared to approximately \$44.8 million at June 30, 2008. The Company's total backlog represents the estimated remaining sales value of work to be performed under firm contracts. The Company's backlog and risks associated with government contracts is discussed in greater detail in Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in Item 7 below.

It is presently anticipated that a minimum of \$29.6 million of orders comprising

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the June 30, 2009 backlog will be filled during the fiscal year ending June 30, 2010. The minimum of \$29.6 million does not include any shipments, which may be made against orders subsequently received during the fiscal year ending June 30, 2010. The estimate of the June 30, 2009 backlog to be shipped in fiscal 2010 is subject to future events, which may cause the amount of the backlog actually shipped to differ from such estimate.

### Marketing and Competition

The Company markets its products primarily through its own direct sales organization. Business is solicited from large industrial manufacturers and defense companies, the government of the United States, foreign governments and major foreign electronic equipment companies. In certain countries the Company has external sales representatives to help solicit and coordinate foreign contracts. The Company is also on the eligible list of contractors of agencies of the United States Department of Defense and generally is automatically solicited by such agencies for procurement needs falling within the major classes of products produced by the Company. In addition, the Company directly solicits bids from the United States Department of Defense for prime contracts.

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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 the United States and foreign government appropriations and program allocations, the competition for available military business, and government termination of orders for convenience.

The Company's business is not considered to be seasonal. Also, management believes that due to the nature of the Company's business the Company will not be adversely affected by recessionary factors in the U.S. economy generally.

### Research and Development

The Company's expenditures for research and development were approximately \$40,678 and \$53,586 in fiscal 2009 and 2008, respectively. Some of the Company's engineers and technicians spend varying degrees of time on either development of new products or improvements of existing products.

### Employees

The Company had 168 employees as of September 8, 2009. Some of these employees are represented by the International Brotherhood of Electrical Workers Local #1799. A new collective bargaining agreement was approved in June 2008. The four-year agreement expires on June 30, 2012. The contract includes pay increases of 4%, 3.75%, 3.75% and 4% for each year, respectively, of the four-year contract. Relations with the Union are considered good. Union membership at September 8, 2009 was 70 people.

### Government Regulations

Compliance with federal, state and local provisions that have been enacted or adopted to regulate the discharge of materials into the environment, or otherwise relating to the protection of the environment, did not in fiscal year

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2009, and the Company believes will not in fiscal year 2010, have a material effect upon the capital expenditures, net income, or competitive position of the Company.

The Company's U.S. government contract and subcontract orders are funded by government budgets, which operate on an October-to-September fiscal year. In February of each year, the President of the United States presents to Congress a proposed budget for the upcoming fiscal year. This budget includes recommended appropriations for every federal agency and is the result of months of policy and program reviews throughout the executive branch. From February through September of each year, the appropriations and authorization committees of Congress review the President's budget proposals and establish the funding levels for the upcoming fiscal year in appropriations and authorization legislation. Once these levels are enacted into law, the Executive Office of the President administers the funds to the agencies.

There are two primary risks associated with this process. First, the process may be delayed or disrupted because of congressional schedules, negotiations over funding levels for programs or unforeseen world events, which could, in turn, alter the funding for a program or contract. Second, funding for multi-year contracts can be changed by future appropriations, which could affect the timing of funds, schedules and program content.

Also, our international sales are denominated in United States currency. Consequently, changes in exchange rates that strengthen the United States dollar could increase the price in local currencies of our products in foreign markets and make our products relatively more expensive than competitors' products.

### U.S. Government Defense Contracts and Subcontracts

Generally, U.S. government contracts are subject to procurement laws and regulations. Some of the Company's contracts are governed by the Federal Acquisition Regulation (FAR), which lays out uniform policies and procedures for acquiring goods and services by the U.S. government, and agency-specific acquisition regulations that implement or supplement the FAR. For example, the Department of Defense implements the FAR through the Defense Federal Acquisition Regulation (DFAR).

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The FAR also contains guidelines and regulations for managing a contract after award, including conditions under which contracts may be terminated, in whole or in part, at the government's convenience or for default. If a contract is terminated for the convenience of the government, a contractor is entitled to receive payments for its allowable costs and, in general, the proportionate share of fees or earnings for the work done. If a contract is terminated for default, the government generally pays for only the work it has accepted. These regulations also subject the company to financial audits and other reviews by the government of its costs, performance, accounting and general business practices relating to its contracts, which may result in adjustment of the company's contract-related costs and fees.

### Item 2. Property

The Company's entire operation, including manufacturing and engineering facilities, is located in Saratoga Springs, New York.

The Saratoga Springs plant, which the Company owns, consists of various adjoining one-story buildings on a 22 acre site, approximately eight acres of which is unimproved. The property is not subject to mortgage indebtedness or any other material encumbrance. The plant has a sprinkler system throughout and

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contains approximately 151,000 square feet of floor space, of which 90,000 is used for manufacturing, 24,000 for engineering, 33,000 for shipping and climatically secured storage, and 4,000 for offices. The offices, engineering and some manufacturing areas are air-conditioned. In addition to assembly and wiring operations, the plant includes facilities for varnishing, potting, plating, impregnation and spray-painting operations. The manufacturing operation also includes a complete machine shop, with welding and sheet metal fabrication facilities adequate for substantially all of the Company's current operations. Besides normal test equipment, the Company maintains a sophisticated on-site environmental test facility. In addition to meeting all of the Company's in-house needs, the plating, machine shop and environmental facilities are available to other companies on a contract basis.

### Item 3. Legal Proceedings

None

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

None

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## PART II

### Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities

#### Price Range of Common Stock

The table below shows the range of high and low prices for the Company's common stock on the NYSE - Amex (ticker symbol "ESP"), the principal market for trading in the common stock, for each quarterly period for the last two fiscal years ended June 30:

2009	High	Low
First Quarter	22.00	18.10
Second Quarter	21.10	16.91
Third Quarter	19.85	13.05
Fourth Quarter	17.00	14.30
2008	High	Low
First Quarter	24.08	19.71
Second Quarter	24.00	17.60
Third Quarter	23.75	14.75
Fourth Quarter	23.20	17.40

#### Holdings

The approximate number of holders of record of the common stock was 109 on September 8, 2009 according to records of the Company's transfer agent. Included in this number are shares held in "nominee" or "street" name and, therefore, the number of beneficial owners of the common stock is believed to be substantially in excess of the foregoing number.

#### Dividends

The Company paid cash dividends on common stock of \$2.40 and \$2.25 per share for the fiscal years ended June 30, 2009 and 2008, respectively, which included a special dividend of \$1.50 per share during each of such fiscal years. The Board

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of Directors has authorized the payment of a fiscal 2010 first quarter dividend of \$.225 payable September 25, 2009 to shareholders of record on September 4, 2009.

During fiscal 2009, the Company sold common stock to certain employees and directors as they exercised existing stock options granted under a shareholder approved plan. During the year, 8,800 shares were sold at prices that ranged from \$11.25 a share to \$17.80 a share. The securities were sold for cash. Proceeds are used for general working capital purposes.

The Company did not make any open market purchases of equity securities in the fiscal 2009 fourth quarter.

The following table sets forth information as of June 30, 2009 with respect to compensation plans under which equity securities of the Company may be issued.

### Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of Securities available for future equity compensation securities
	(a)	(b)	
Equity compensation plans approved by security holders	140,400	\$17.43	3
Equity compensation plans not approved by security holders	-----		---
Total	140,400		3

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#### Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

##### Business Outlook

The business outlook for the Company is excellent. The order backlog, together with potential new orders realized from outstanding quotations by the Company, remain at a high level. Expectations are for product mix and margins to remain favorable for fiscal year 2010, and management expects revenues to increase in fiscal year 2010 over fiscal year 2009. During fiscal 2009 new orders received by the Company were approximately \$21.6 million. The order backlog of approximately \$39.1 million at June 30, 2009 gives the Company a solid base of future sales. It is presently anticipated that a minimum of \$29.6 million of orders comprising the June 30, 2009 backlog will be filled during the fiscal year ending June 30, 2010. The minimum of \$29.6 million does not include any shipments, which may be made against orders subsequently received during the fiscal year ending June 30, 2010. The backlog represents the estimated remaining sales value of work to be performed under firm contracts.

In addition to the backlog, the Company currently has outstanding quotations

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representing in excess of \$66.6 million in the aggregate for both repeat and new programs. Many potential orders are currently being discussed and negotiated with existing and potential new 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.

Two significant customers in fiscal 2009 and 2008 represented 63% and 56%, respectively, of the Company's total sales. These sales represent significant programs which the Company is a significant supplier of parts. While the Company has always had a small number of customers that make up its total sales in any given year, management is pursuing opportunities with current and new customers with an objective of lowering the overall concentration of sales, mitigating excessive reliance upon a single major product of a particular program and minimizing the impact of loss of a single significant customer. We anticipate significant new orders against the three programs discussed below in the Results of Operations, which, if realized, will diversify our customer base.

Management continues to invest in capital equipment to upgrade its technology and stay current with the industry. Capital expenditures are expected to be approximately \$350,000 for fiscal 2010. Also, management along with the Company's Board of Directors continues to look for potential opportunities to expand the Company's business through acquisitions.

### Results of Operations

Net Sales for fiscal years ended June 30, 2009 and 2008, were \$27,241,635 and \$25,701,739, respectively, a 6% increase. This increase can be attributed to the contract specific nature of the Company's business and the timing of deliveries on these contracts. More specifically, shipments of power supplies, spares, and antennas increased by approximately \$2.3 million offset by a decrease of approximately \$.9 million in transformer shipments.

For the fiscal years ended June 30, 2009 and 2008 gross profits were \$6,086,726 and \$6,862,246, respectively. Gross profit as a percentage of sales was 22.3% and 26.7%, for fiscal 2009 and 2008, respectively. The primary factor in determining gross profit and net income is product mix. The gross profits on mature products and build to print contracts are higher as compared to products that are still in the engineering development stage or in the early stages of production. In any given accounting period the mix of product shipments between higher margin mature programs and less mature programs including loss contracts, has a significant impact on gross profit and net income. The reduced gross profit and gross profit percentage in fiscal 2009 as compared to fiscal 2008 was primarily the result of unexpected losses incurred on three programs with significant engineering and production time required for design efforts. These three programs experienced significant cost overruns due to extended product qualification testing and difficulties moving the products from engineering design into full production. Currently, one program has completed qualification testing and has moved into full production. The other two programs are still in pre-qualification stages and have made significant progress towards completion. Management is not anticipating any significant future losses on these programs. Management continues to evaluate the Company's workforce to ensure that production and overall execution of the backlog orders and additional anticipated orders are successfully obtained and executed. Employment of full time equivalents at June 30, 2009 was 169 compared to 170 people at June 30, 2008.

Selling, general and administrative expenses were \$2,826,676 for the fiscal year ended June 30, 2009, an increase of \$203,363, or 7.8% as compared to the prior year. This increase relates primarily to an increase in wages and commissions,



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travel expenses and consulting fees.

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Other income for the fiscal years ended June 30, 2009 and 2008 was \$345,010 and \$712,252, respectively, a 51.6% decrease. This decrease is due to a drop in scrap metal income and interest income on the Company's cash and cash equivalents and short-term investments. The decrease in interest income is due to lower interest rates available as well as lower cash and cash equivalent and short-term investment balances. The Company does not believe that there is significant risk associated with its investment policy, since at June 30, 2009 all of the investments were primarily represented by short-term liquid investments including certificates of deposit and money market funds.

The effective income tax rate was 24.2% in fiscal 2009 and 30.9% in fiscal 2008. The effective tax rate is less than the statutory tax rate mainly due to the benefit the Company receives on its Qualified Production Activities and the benefit derived from the ESOP dividends paid on allocated shares. The deduction for ESOP dividends was substantially larger in 2009 as compared to 2008, due to the special dividend of \$1.50 per share that was paid to ESOP participants in August 2009.

Net income for fiscal 2009, was \$2,733,240 or \$1.30 and \$1.29 per share, basic and diluted, respectively, compared to net income of \$3,421,869 or \$1.65 and \$1.63 per share, basic and diluted, respectively, for fiscal 2008. The decrease in net income per share was primarily due to loss contracts in three programs described above resulting in lower gross profits, higher selling, general and administrative costs and the decrease in interest income.

### Liquidity and Capital Resources

The Company's working capital is an appropriate indicator of the liquidity of its business, and during the past 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 three fiscal years. Management had available a \$3,000,000 line of credit to help fund further growth or working capital needs, but did not anticipate the need for any borrowed funds in the foreseeable future and therefore did not renew the line of credit which expired November 30, 2007.

The Company's working capital as of June 30, 2009 and 2008 was \$25,726,492 and \$27,448,722, respectively. During 2009 and 2008 the Company repurchased 19,899 and 36,091 shares, respectively, of its common stock from the Company's Employee Retirement Plan and Trust ("ESOP") and in other open market transactions, for a total purchase price of \$311,545 and \$769,443 respectively. Under existing authorizations from the Company's Board of Directors, as of June 30, 2009, management is authorized to purchase an additional \$1,688,454 million of Company stock.

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

	2009	2008
	----	----
Net cash provided by operating activities	\$ 384,936	\$ 4,147,247
Net cash provided by (used in) investing activities	731,666	(3,598,961)
Net cash used in financing activities	(5,193,036)	(4,792,644)

Net cash provided by operating activities fluctuates between periods primarily as a result of differences in net income, the timing of the collection of

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accounts receivable, purchase of inventory, receipt of progress payments, level of sales and payments of accounts payable. Net cash provided by investing activities increased in fiscal 2009 due to the increase in proceeds from the maturity of short-term investments. The increase in cash used in financing activities is due primarily to an increase in dividends paid on common stock. Included in dividends paid are two special dividends of \$1.50 per share that were paid in December 2008 and March 2008.

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

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

During fiscal year 2009 and fiscal 2008, the Company expended \$280,790 and \$517,959, respectively, for plant improvements and new equipment. The Company has budgeted approximately \$350,000 for new equipment and plant improvements in fiscal 2010. Management anticipates that the funds required will be available from current operations.

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### Critical Accounting Policies and Estimates

Our significant accounting policies are described in note 2 to the financial statements. We believe our most critical accounting policies include revenue recognition and cost estimation on our contracts.

### Revenue Recognition and Estimates

A significant portion of our business is comprised of development and production contracts. Generally revenues on long-term fixed-price contracts are recorded on a percentage of completion basis using units of delivery as the measurement basis for progress toward completion.

Percentage of completion accounting requires judgment relative to expected sales, estimating costs and making assumptions related to technical issues and delivery schedules. 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.

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### Item 8. Financial Statements and Supplementary Data

#### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of  
Espey Mfg. & Electronics Corp.

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Saratoga Springs, New York

We have audited the accompanying balance sheet of Espey Mfg. & Electronics Corp. as of June 30, 2009 and 2008, and the related statements of income, stockholders' equity, and cash flows for each of the years in the two-year period ended June 30, 2009. Espey Mfg. & Electronics Corp.'s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Espey Mfg. & Electronics Corp. as of June 30, 2009 and 2008, and the results of its operations and its cash flows for each of the years in the two-year period ended June 30, 2009 in conformity with accounting principles generally accepted in the United States of America.

/s/Rotenberg & Co. LLP

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 Rochester, New York  
 September 7, 2009

Espey Mfg. & Electronics Corp.  
 Balance Sheet  
 June 30, 2009 and 2008

	2009
	----
<b>ASSETS</b>	
Cash and cash equivalents .....	\$ 2,775,319
Short term investments .....	6,349,874
Trade accounts receivable, net .....	5,133,792
Income tax receivable .....	--
ESOP receivable due to dividends on unallocated shares .....	71,053
Other receivables .....	297
 Inventories:	
Raw materials .....	1,394,441
Work-in-process .....	1,107,880

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Costs related to contracts in process, net of progress payments of \$60,079 in 2009 and \$959,175 in 2008 .....	10,526,884
Total inventories .....	13,029,205
Deferred income taxes .....	224,835
Prepaid expenses and other current assets .....	233,072
Total current assets .....	27,817,447
Property, plant and equipment, net .....	2,738,222
Loan receivable .....	38,673
Total assets .....	\$ 30,594,342
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	
Accounts payable .....	\$ 999,521
Accrued expenses:	
Salaries, wages and commissions .....	219,533
Vacation .....	520,072
Other .....	42,863
Payroll and other taxes withheld and accrued .....	42,075
Income taxes payable .....	266,891
Total current liabilities .....	2,090,955
Deferred income taxes .....	99,253
Total liabilities .....	2,190,208
Common stock, par value \$.33-1/3 per share	
Authorized 10,000,000 shares; Issued 3,029,874 shares in 2009 and 2008. Outstanding 2,314,803 and 2,325,902 in 2009 and 2008, respectively (includes 201,666 and 225,000 Unearned ESOP Shares) .....	1,009,958
Capital in excess of par value .....	13,755,808
Retained earnings .....	23,485,675
	38,251,441
Less: Unearned ESOP shares .....	(2,914,077)
Cost of 715,071 and 703,972 shares of common stock in treasury in 2009 and 2008, respectively .....	(6,933,230)
Total stockholders' equity .....	28,404,134
Total liabilities and stockholders' equity .....	\$ 30,594,342

The accompanying notes are an integral part of the financial statements.

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Years Ended June 30, 2009 and 2008

	2009 -----	2008 -----
Net sales .....	\$ 27,241,635	\$ 25,701,739
Cost of sales .....	21,154,909	18,839,493
	-----	-----
Gross profit .....	6,086,726	6,862,246
Selling, general and administrative expenses ....	2,826,676	2,623,313
	-----	-----
Operating income .....	3,260,050	4,238,933
Other income (expense)		
Interest and dividend income .....	327,260	640,412
Other .....	17,750	71,840
	-----	-----
Total other income, net .....	345,010	712,252
	-----	-----
Income before income taxes .....	3,605,060	4,951,185
Provision for income taxes .....	871,820	1,529,316
	-----	-----
Net income .....	\$ 2,733,240	\$ 3,421,869
	=====	=====
Net income per share:		
Basic .....	\$ 1.30	\$ 1.65
Diluted .....	\$ 1.29	\$ 1.63
	-----	-----
Weighted average number of shares outstanding:		
Basic .....	2,107,643	2,079,734
Diluted .....	2,113,798	2,103,836
	=====	=====

The accompanying notes are an integral part of the financial statements.

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Espey Mfg. & Electronics Corp.  
 Statements of Changes in Stockholders' Equity  
 Years Ended June 30, 2009 and 2008

	Outstanding Common Shares	Amount	Capital in Excess of Par Value	Unearned ESOP Shares
	-----	-----	-----	-----
Balance as of June 30, 2007	2,316,893	\$ 1,009,958	\$12,890,269	\$ (3,600,459)
	-----	-----	-----	-----
Net income, 2008				

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Stock options exercised	45,100		200,744	
Stock option expense			143,530	
Dividends paid on common stock \$2.25 per share				
Tax effect of stock options exercised			83,471	
Purchase of treasury stock	(36,091)			
Reduction of unearned ESOP shares			158,595	349,211
	-----	-----	-----	-----
Balance as of June 30, 2008	2,325,902	\$ 1,009,958	\$13,476,609	\$(3,251,248)
	-----	-----	-----	-----
Net income, 2009				
Stock options exercised	8,800		59,932	
Stock option expense			109,921	
Dividends paid on common stock \$2.40 per share				
Tax effect of stock options exercised			30,245	
Purchase of treasury stock	(19,899)			
Reduction of unearned ESOP shares			79,101	337,171
	-----	-----	-----	-----
Balance as of June 30, 2009	2,314,803	\$ 1,009,958	\$13,755,808	\$(2,914,077)
	=====	=====	=====	=====

The accompanying notes are an integral part of the financial statements.

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	Treasury Stock		Total Stockholders' Equity
	Shares	Amount	
	-----	-----	-----
Balance as of June 30, 2007	712,981	\$ (6,296,917)	\$ 31,057,176
	-----	-----	-----
Net income, 2008			3,421,869
Stock options exercised	(45,100)	372,075	572,819
Stock option expense			143,530

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Dividends paid on common stock \$2.25 per share			(4,679,491)
Tax effect of stock options exercised			83,471
Purchase of treasury stock	36,091	(769,443)	(769,443)
Reduction of unearned ESOP shares			507,806
	-----	-----	-----
Balance as of June 30, 2008	703,972	\$ (6,694,285)	\$ 30,337,737
	=====	=====	=====
Net income, 2009			2,733,240
Stock options exercised	(8,800)	72,600	132,532
Stock option expense			109,921
Dividends paid on common stock \$2.40 per share			(5,044,268)
Tax effect of stock options exercised			30,245
Purchase of treasury stock	19,899	(311,545)	(311,545)
Reduction of unearned ESOP shares			416,272
	-----	-----	-----
Balance as of June 30, 2009	715,071	\$ (6,933,230)	\$ 28,404,134
	=====	=====	=====

The accompanying notes are an integral part of the financial statements.

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Espey Mfg. & Electronics Corp.  
Statements of Cash Flows  
Years Ended June 30, 2009 and 2008

	2009
	-----
Cash Flows From Operating Activities:	
Net income .....	\$ 2,733,240
Adjustments to reconcile net income to net cash provided by operating activities:	
Excess tax benefits from share-based compensation .....	30,245
Stock-based compensation .....	109,921
Depreciation .....	488,461
ESOP compensation expense .....	416,272
Loss on disposal of assets .....	10,695

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Deferred income tax benefit .....	(88,305)	
Changes in assets and liabilities:		
Increase in trade receivables, net .....	(1,487,665)	
Decrease (increase) in income tax receivable .....	276,087	
Decrease (increase) in other receivables .....	4,051	
Increase in ESOP receivable due to dividends on unallocated shares ..	(34,244)	
(Increase) decrease in inventories, net .....	(2,840,971)	
Decrease in prepaid expenses and other current assets .....	122,616	
Increase (decrease) in accounts payable .....	398,590	
Decrease in accrued salaries, wages and commissions .....	35,156	
(Decrease) increase in other accrued expenses .....	(3,390)	
Decrease in vacation accrual .....	(22,369)	
(Decrease) increase in payroll and other taxes withheld and accrued..	(100)	
Increase (decrease) in income taxes payable .....	236,646	
	-----	
Net cash provided by operating activities .....	\$ 384,936	-----

The accompanying notes are an integral part of the financial statements.

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### Cash Flows From Investing Activities:

Additions to property, plant and equipment .....	(280,790)	
Payment for loan receivable .....	--	
Proceeds from return of loan receivable .....	26,330	
Purchase of short term investments .....	(8,087,874)	(8,
Proceeds from maturity of short term investments .....	9,074,000	5,
	-----	-----
Net cash provided by (used in) investing activities	731,666	(3,
	-----	-----

### Cash Flows From Financing Activities:

Dividends on common stock .....	(5,044,268)	(4,
Purchase of treasury stock .....	(311,545)	(



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Proceeds from exercise of stock options .....	132,532	
Excess tax benefits from share-based compensation .....	30,245	
	-----	-----
Net cash used in financing activities .....	(5,193,036)	(4,
	-----	-----
Decrease in cash and cash equivalents .....	(4,076,434)	(4,
Cash and cash equivalents, beginning of the year .....	6,851,753	11,
	-----	-----
Cash and cash equivalents, end of the year .....	\$ 2,775,319	\$ 6,
	=====	=====
Supplemental Schedule of Cash Flow Information:		
Income taxes paid .....	\$ 470,000	\$ 1,
	=====	=====

The accompanying notes are an integral part of the financial statements.

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Espey Mfg. & Electronics Corp.  
Notes to Financial Statements

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Note 1. Nature of operations

Espey Mfg. & Electronics Corp. (the Company) is a manufacturer of electronic equipment used primarily in military and industrial applications. The principal markets for the Company's products are companies that provide electronic support to both military and industrial applications.

Note 2. Summary of Significant Accounting Policies

**Inventory Valuation, Cost Estimation and Revenue Recognition** Raw materials are valued at weighted average cost.

Inventoried work relating to contracts in process and work in process is valued at actual production cost, including factory overhead incurred to date. Work in process represents spare units; parts and other inventory items acquired or produced to service units previously sold or to meet anticipated future orders. The cost elements of contracts in process and work in process consist of production costs of goods and services currently in process and overhead. Provision for losses on contracts is made when the existence of such losses becomes probable and estimable. The costs attributed to units delivered under contracts are based on the estimated average cost of all units expected to be produced. Certain contracts are expected to extend beyond twelve months.

Revenue is recognized on contracts in the period in which the units are delivered and billed (units-of-delivery method). 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

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sales, estimating costs and making assumptions related to technical issues and delivery schedules. 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.

### Depreciation

Depreciation of plant and equipment is computed on a straight-line basis over the estimated useful lives of the assets.

Estimated useful lives of depreciable assets are as follows:

Buildings and improvements	10 - 35 years
Machinery and equipment	3 - 20 years
Furniture and fixtures	5 - 10 years

### Income Taxes

The Company follows the provisions of Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes."

Under the provisions of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date. In addition, SFAS No. 109 requires that the tax benefit of tax-deductible dividends on unallocated ESOP shares be recorded as a direct addition to retained earnings rather than as a reduction of income tax expense.

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Espey Mfg. & Electronics Corp.  
Notes to Financial Statements

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### Note 2. Summary of Significant Accounting Policies, Continued

#### Cash and Cash Equivalents

Cash and cash equivalents consist of cash in banks, certificates of deposit, and money market funds. The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Short-term investments include certificates of deposit with maturities greater than three months to a year.

#### Accounts receivable and allowance for doubtful accounts

The Company extends credit to its customers in the normal course of business and collateral is generally not required for trade receivables. Exposure to credit risk is controlled through the use of credit approvals, credit limits and monitoring procedures. Accounts receivable are reported net of an allowance for doubtful accounts. The Company estimates the allowance based on its analysis of specific balances. An account is generally considered past due after thirty (30) days from the invoice date. Based on these factors, there was an allowance for

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doubtful accounts of \$3,000 at June 30, 2009. Changes to the allowance for doubtful accounts are charged to expense and reduced by charge-offs, net of recoveries.

### Per Share Amounts

SFAS 128 "Earnings Per Share" requires the Company to calculate net income (loss) per share based on basic and diluted net income (loss) per share, as defined. Basic EPS excludes dilution and is computed by dividing net income (loss) by the weighted average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. The dilutive effect of outstanding options issued by the Company are reflected in diluted EPS using the treasury stock method. Under the treasury stock method, options will only have a dilutive effect when the average market price of common stock during the period exceeds the exercise price of the options.

### Comprehensive Income

Comprehensive Income for the years ended June 30, 2009 and 2008 is equal to net income.

### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### Investment Tax Credits

Investment tax credits are accounted for as a reduction of income tax expense in the year taxes payable are reduced.

### Reclassifications

Certain reclassifications may have been made to the prior year financial statements to conform to the current year presentation.

### Recently Issued Accounting Standards

In May 2009, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") No. 165, Subsequent Events ("SFAS 165"). SFAS 165 establishes principles and requirements for subsequent events. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009. As such, the Company is required to adopt this standard in the current period. Adoption of SFAS 165 did not have a significant effect on the Company's consolidated financial statements.

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

Note 2. Summary of Significant Accounting Policies, Continued

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

In December 2007, the FASB issued Statement of Financial Accounting Standard No. 160 ("SFAS 160"), Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51. SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. As such, the Company was required to adopt these provisions on January 1, 2009. The adoption of the provisions of SFAS 160 did not have a material effect on the Company's financial statements.

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

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

Impairment of Long-Lived Assets

Long-lived assets, including property, plant, and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and no longer depreciated. The assets and liabilities of a disposed group classified as held for sale are presented separately in the appropriate asset and liability sections of the balance sheet

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### Concentrations of Risk

The market for our defense electronics products is largely dependent on the availability of new contracts from the United States and foreign governments to prime contractors to which we provide components. Any decline in expenditures by the United States or foreign governments may have an adverse effect on our financial performance.

Generally, U.S. government contracts are subject to procurement laws and regulations. Some of the Company's contracts are governed by the Federal Acquisition Regulation (FAR), which lays out uniform policies and procedures for acquiring goods and services by the U.S. government, and agency-specific acquisition regulations that implement or supplement the FAR. For example, the Department of Defense implements the FAR through the Defense Federal Acquisition Regulation (DFAR).

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Espey Mfg. & Electronics Corp.  
Notes to Financial Statements

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### Note 2. Summary of Significant Accounting Policies, Continued

The FAR also contains guidelines and regulations for managing a contract after award, including conditions under which contracts may be terminated, in whole or in part, at the government's convenience or for default. If a contract is terminated for the convenience of the government, a contractor is entitled to receive payments for its allowable costs and, in general, the proportionate share of fees or earnings for the work done. If a contract is terminated for default, the government generally pays for only the work it has accepted. These regulations also subject the Company to financial audits and other reviews by the government of its costs, performance, accounting and general business practices relating to its contracts, which may result in adjustment of the Company's contract-related costs and fees.

### Note 3. Contracts in Process

Contracts in process at June 30, 2009 and 2008 are as follows:

	2009	2008
Gross contract value	\$39,116,487	\$44,784,584
Costs related to contracts in process, net of progress payments of \$60,079 in fiscal 2009 and \$959,175 in fiscal 2008	\$10,526,884	\$ 7,461,786

Included in costs relating to contracts in process at June 30, 2009 and 2008 are costs of \$974,342 and \$1,911,986, respectively, relative to contracts that may not be completed within the ensuing year. Under the units-of-delivery method, the related sale and cost of sales will not be reflected in the statement of income until the units under contract are shipped.

### Note 4. Property, Plant and Equipment

A summary of the original cost of property, plant and equipment at June 30, 2009 and 2008 is as follows:

2009	2008

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Land	\$ 45,000	\$ 45,000
Building and improvements	4,638,879	4,639,626
Machinery and equipment	6,723,573	6,706,540
Furniture and fixtures	156,884	156,884
	-----	-----
	11,564,336	11,548,050
Accumulated depreciation	(8,826,114)	(8,591,460)
	-----	-----
	\$ 2,738,222	\$ 2,956,590
	=====	=====

Depreciation expense was \$488,461 and \$491,526, during the years ended June 30, 2009 and 2008, respectively.

### Note 5. Line of credit

Management had available a \$3,000,000 line of credit to help fund further growth or working capital needs, but did not anticipate the need for any borrowed funds in the foreseeable future and therefore did not renew the line of credit which expired November 30, 2007.

### Note 6. Pension Expense

Under terms of a negotiated union contract, the Company is obligated to make contributions to a union-sponsored defined benefit pension plan covering eligible employees. Such contributions and expenses are based upon hours worked at a specified rate and amounted to \$95,711 in fiscal 2009 and \$87,159 in fiscal 2008.

The Company sponsors a 401(k) plan with employee and employer matching contributions. The employer match is 10% of the employee contribution and was \$31,647 and \$30,125, for fiscal years 2009 and 2008, respectively.

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Espey Mfg. & Electronics Corp.  
Notes to Financial Statements

### Note 7. Provision for Income Taxes

A summary of the components of the provision for income taxes for the years ended June 30, 2009 and 2008 is as follows:

	2009	2008
	-----	-----
Current tax expense - federal	\$ 953,319	\$ 1,561,918
Current tax expense - state	6,806	5,909
Deferred tax (benefit) expense	(88,305)	(38,511)
	-----	-----
	\$ 871,820	\$ 1,529,316
	=====	=====

Deferred income taxes reflect the impact of "temporary differences" between the amount of assets and liabilities for financial reporting purposes and such amounts measured by tax laws and regulations. These "temporary differences" are determined in accordance with SFAS No. 109.

The combined U.S. federal and state effective income tax rates of 24.2% and 30.9%, for 2009 and 2008 respectively, differed from the statutory U.S. federal income tax rate for the following reasons:

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	2009	2008
	-----	-----
U.S. federal statutory income tax rate	34.0%	34.0%
Increase (reduction) in rate resulting from:		
State franchise tax, net of federal income tax benefit	0.1	0.1
ESOP cost versus Fair Market Value	0.7	1.1
Dividend on allocated ESOP shares	(8.9)	(1.6)
Qualified Production Activities	(1.7)	(2.0)
Stock-based compensation	.1	(0.7)
Other	(.1)	--
	-----	-----
Effective tax rate	24.2%	30.9%
	=====	=====

For the years ended June 30, 2009 and 2008 deferred income tax benefit of \$(88,305) and \$(38,511), respectively, result from the changes in temporary differences for each year. The tax effects of temporary differences that give rise to deferred tax assets and deferred tax liabilities as of June 30, 2009 and 2008 are presented as follows:

	2009	2008
	-----	-----
Deferred tax assets:		
Accrued expenses .....	\$124,157	\$126,808
ESOP .....	95,319	77,987
Stock-based compensation .....	8,996	6,775
Inventory - effect on uniform capitalization ..	83,575	26,699
Other .....	8,108	9,572
	-----	-----
Total deferred tax assets .....	320,155	247,841
	-----	-----
Deferred tax liabilities:		
Property, plant and equipment - principally due to differences in depreciation methods .....	194,573	210,564
	-----	-----
Total deferred tax liabilities .....	194,573	210,564
	-----	-----
Net deferred tax asset .....	\$125,582	\$ 37,277
	=====	=====

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projection for future taxable income over the period in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these temporary differences without consideration of a valuation allowance.

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Espey Mfg. & Electronics Corp.  
Notes to Financial Statements

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### Note 7. Provision for Income Taxes, Continued

As the result of the implementation of the FASB interpretation No. 48 ("FIN 48"), Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109, the Company recognized no material adjustments to unrecognized tax benefits. At the adoption date of July 1, 2007, and as of June 30, 2009, the Company has no unrecognized tax benefits.

The Company recognizes interest and penalties related to uncertain tax positions, if any, in general and administrative expense. As of June 30, 2009, the Company has not recorded any provision for accrued interest and penalties related to uncertain tax positions.

By statute, tax years ending June 30, 2009, 2008 and 2007 remain open to examination by the major taxing jurisdictions to which the Company is subject.

### Note 8. Significant Customers

A significant portion of the Company's business is the production of military and industrial electronic equipment for use by the U.S. and foreign governments and certain industrial customers. Sales to two domestic customers accounted for 33% and 30% of total sales in fiscal 2009. Sales to two domestic customers accounted for 31% and 25% of total sales in fiscal 2008.

Export sales in fiscal 2009 and fiscal 2008 were approximately \$4,691,000 and \$5,538,000, respectively.

### Note 9. Stock Rights Plan

The Company has a Shareholder Rights Plan that expires on December 31, 2009. Under this plan, common stock purchase rights were distributed as a dividend at the rate of one right for each share of common stock outstanding as of or issued subsequent to April 14, 1989. Each right entitles the holder thereof to buy one-half share of common stock of the Company at an exercise price of \$25 per share subject to adjustment. The rights are exercisable only if a person or group acquires beneficial ownership of 15% or more of the Company's common stock or commences a tender or exchange offer which, if consummated, would result in the offeror individually or, together with all affiliates and associates thereof, being the beneficial owner of 15% or more of the Company's common stock.

If a 15% or larger shareholder should engage in certain self-dealing transactions or a merger with the Company in which the Company is the surviving corporation and its shares of common stock are not changed or converted into equity securities of any other person, or if any person were to become the beneficial owner of 15% or more of the Company's common stock, then each right not owned by such shareholder or related parties of such shareholder (all of which will be void) will entitle its holder to purchase, at the right's then current exercise price, shares of the Company's common stock having a value of twice the right's exercise price. In addition, if the Company is involved in any other merger or consolidation with, or sells 50% or more of its assets or earning power to another person, each right will entitle its holder to purchase, at the right's then current exercise price, shares of common stock of such other person having a value of twice the right's exercise price.

The Company generally is entitled to redeem the rights at one cent per right at any time until the 15th day (or 25th day if extended by the Company's Board of Directors) following public announcement that a 15% position has been acquired



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or the commencement of a tender or exchange offer which, if consummated, would result in the offer or, together with all affiliates and associates thereof, being the beneficial owner of 15% or more of the Company's common stock.

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Espey Mfg. & Electronics Corp.  
Notes to Financial Statements

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### Note 10. Employee Stock Ownership Plan

The Company sponsors a leveraged employee stock ownership plan (the "ESOP") that covers all nonunion employees who work 1,000 or more hours per year and are employed on June 30. The Company makes annual contributions to the ESOP equal to the ESOP's debt service less dividends on unallocated shares received by the ESOP. All dividends on unallocated shares received by the ESOP are used to pay debt service. Dividends on allocated ESOP shares are recorded as a reduction of retained earnings. As the debt is repaid, shares are released and allocated to active employees, based on the proportion of debt service paid in the year. The Company accounts for its ESOP in accordance with Statement of Position 93-6. Accordingly, the shares purchased by the ESOP are reported as Unearned ESOP Shares in the statement of financial position. As shares are released or committed-to-be-released, the Company reports compensation expense equal to the current average market price of the shares, and the shares become outstanding for earnings-per-share (EPS) computations. ESOP compensation expense was \$416,272 for the year ended June 30, 2009 and \$507,805 for the year ended June 30, 2008. The ESOP shares as of June 30, 2009 and 2008 were as follows:

	2009	2008
	-----	-----
Allocated Shares	450,228	442,243
Committed-to-be-released shares	--	--
Unreleased shares	201,666	225,000
	-----	-----
 Total shares held by the ESOP	 651,894	 667,243
	=====	=====
 Fair value of unreleased shares	 \$3,095,573	 \$4,272,750
	=====	=====

### Note 11. Stock-based Compensation

The Company follows Statement of Financial Accounting Standards No. 123(R) 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 maybe settled by the issuance of those equity instruments. SFAS No. 123(R) requires that the cost resulting from all share-based payment transactions be recognized in the financial statements based on the fair value of the share-based payment. SFAS No.123(R) establishes fair value as the measurement objective in accounting for share-based payment transactions with employees, except for equity instruments held by employee share ownership plans.

Total stock-based compensation expense recognized in the Statement of Income for the fiscal years ended June 30, 2009 and 2008, was \$109,921 and \$143,530, respectively, before income taxes. The related total deferred tax benefit was approximately \$9,683 and \$11,239, for the same periods. SFAS No. 123(R) requires the tax benefits resulting from tax deductions in excess of the compensation

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cost recognized for those options to be classified and reported as both an operating cash outflow and a financing cash inflow on a prospective basis upon adoption.

As of June 30, 2009, there was approximately \$116,045 of unrecognized compensation cost related to stock option awards that is expected to be recognized as expense over the next 1.75 years. The total deferred tax benefit related to these awards is approximately \$11,003.

The Company has one employee stock option plan under which options may be granted, the 2007 Stock Option and Restricted Stock Plan (the "2007 Plan"). The Board of Directors may grant options to acquire shares of common stock to employees of the Company at the fair market value of the common stock on the date of grant. Generally, options granted have a two-year vesting period based on two years of continuous service and have a ten-year contractual life. Option grants provide for accelerated vesting if there is a change in control. Shares issued upon the exercise of options are from those held in Treasury. The 2007 Plan was approved by the Company's shareholders at the Company's Annual Meeting on November 30, 2007 and supercedes the Company's 2000 Stock Option Plan (the "2000 Plan"). Options covering 400,000 shares are authorized for issuance under the 2007 Plan, and 61,500 have been granted and are outstanding as of June 30, 2009. While no further grants of options may be made under the 2000 Plan, as of June 30, 2009, 78,900 options remain outstanding, vested and exercisable from the 2000 Plan.

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Espey Mfg. & Electronics Corp.  
Notes to Financial Statements

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### Note 11. Stock-based Compensation, Continued

SFAS No. 123(R) requires the use of a valuation model to calculate the fair value of stock-based awards. The Company has elected to use the Black-Scholes option valuation model, which incorporates various assumptions including those for volatility, expected life and interest rates.

The table below outlines the weighted average assumptions that the Company used to calculate the fair value of each option award for the years ended June 30, 2009 and 2008, respectively:

	2009	2008
	-----	-----
Dividend yield	5.30%	3.70%
Expected stock price volatility	31.41%	27.03%
Risk-free interest rate	1.79%	3.12%
Expected option life (in years)	4.3 years	4.0 years
Weighted average fair value per share of options granted during the period	\$2.767	\$3.934

The Company pays dividends quarterly and anticipates that it will be able to continue to pay dividends in the foreseeable future. Expected stock price volatility is based on the historical volatility of the Company's stock. The risk-free interest rate is based on the implied yield available on U.S. Treasury issues with an equivalent term approximating the expected life of the options. The expected option life (in years) represents the estimated period of time until exercise and is based on actual historical experience.

The following table summarizes stock option activity during the year ended June 30, 2009:

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Employee Stock Options Plan			
	Number of Shares Subject To Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Balance at July 1, 2008	126,500	\$18.40	7.36
Granted	31,800	\$17.09	9.64
Exercised	(8,800)	\$15.06	--
Forfeited or expired	(9,100)	\$18.81	--
Balance at June 30, 2009	140,400	\$18.29	7.90
Exercisable at June 30, 2009	78,900	\$17.43	6.84

The intrinsic value of stock options exercised was \$21,073 and \$258,783, during the year ended June 30, 2009 and 2008, respectively. The intrinsic value of stock options outstanding and exercisable as of June 30, 2009 and 2008 was \$26,220 and \$138,299, respectively.

Note 12. Financial Instruments/Concentration of Credit Risk

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 June 30, 2009 and 2008 because of the relatively short maturities of these instruments.

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short-term investments and accounts receivable. The Company maintains cash and cash equivalents with various financial institutions. At times such investments may be in excess of FDIC insurance limits. As disclosed in note 8, a significant portion of the Company's business is the production of military and industrial electronic equipment for use by the U.S. and foreign governments and certain industrial customers. The related accounts receivable balance, as a percentage of the Company's total trade accounts receivable balance, was 79% represented by four customers at June 30, 2009, and 56.8%, by three customers at June 30, 2008.

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Notes to Financial Statements

Note 12. Financial Instruments/Concentration of Credit Risk, Continued

Although the Company's exposure to credit risk associated with nonpayment of these concentrated balances is affected by the conditions or occurrences within the U.S. and foreign governments, the Company believes that its trade accounts receivable credit risk exposure is limited. The Company performs ongoing credit evaluations of its customer's financial conditions and requires collateral, such as progress payments, in certain circumstances. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information.

Note 13. Related Parties

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The administration of the shares of common stock held by the ESOP Trust is subject to the Second Amended and Restated Plan, effective as of July 1, 2002, creating the Trust, and a Trust Agreement dated July 15, 2005. The Trustees' rights with respect to the disposition of shares are governed by the terms of the Plan and the Trust Agreement. As to shares that have been allocated to the accounts of participants in the ESOP Trust, the Plan provides that the Trustees are required to vote such shares in accordance with instructions received from the participants. As to unallocated shares and allocated shares for which voting instructions have not been received from participants, the Plan provides that the Trustees are required to vote such shares in accordance with the direction of a Committee, appointed by the Board of Directors of the Company under the terms of the Plan and Trust Agreement. See note 10 for additional information regarding the ESOP.

### Note 14. 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 June 30, 2009 and 2008.

### Note 15. Stockholders' Equity

#### Reservation of Shares

The Company has reserved common shares for future issuance as follows as of June 30, 2009:

Stock options outstanding	140,400
Stock options available for issuance	338,500
	-----
Number of common shares reserved	478,900
	=====

The following table sets forth the reconciliation of the numerators and denominators of the basic and diluted per share computations for continuing operations for the years ended June 30:

	2009	2008
	-----	-----
Numerator:		
Net Income	\$ 2,733,240	\$ 3,421,869
	=====	=====
Denominator:		
Basic EPS:		
Common shares outstanding, beginning of period	2,325,902	2,316,893
Unearned ESOP shares	(225,000)	(249,167)
Weighted average common shares issued during the period	5,934	24,026
Weighted average common shares purchased during the period	(7,967)	(21,114)
Weighted average ESOP shares earned during the period	8,774	9,096
	-----	-----
Denominator for basic earnings per common shares -		
Weighted average common shares	2,107,643	2,079,734
	=====	=====

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Espey Mfg. & Electronics Corp.  
Notes to Financial Statements

### Note 15. Stockholders' Equity, Continued

#### Diluted EPS:

Common shares outstanding, beginning of period	2,325,902	2,316,8
Unearned ESOP shares	(225,000)	(249,1
Weighted average common shares issued during the period	5,934	24,0
Weighted average common shares purchased during the period	(7,967)	(21,1
Weighted average ESOP shares earned during the period	8,774	9,0
Weighted average dilutive effect of issued or forfeited shares	6,155	24,1
	-----	-----
Denominator for diluted earnings per common shares -		
Weighted average common shares	2,113,798	2,103,8
	=====	=====

Not included in this computation of earnings per share for the year ended June 30, 2009 and 2008 were options to purchase 136,000 and 34,400, respectively, of the Company's common stock. These options were excluded because their inclusion would have been anti-dilutive due to the average strike price exceeding the average market price of those shares.

### Note 16. Quarterly Financial Information (Unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2009	-----	-----	-----	-----
Net Sales .....	\$ 6,053,519	\$ 6,194,177	\$ 6,709,880	\$ 8,284,059
Gross profit .....	1,151,275	625,930	1,732,812	2,576,709
Net income .....	398,296	(42,412)	781,272	1,596,084
Net income per share -				
Basic .....	.19	(.02)	.37	.76
Diluted .....	.19	(.02)	.37	.75
				2008
Net Sales .....	\$ 6,301,786	\$ 6,732,144	\$ 6,479,020	\$ 6,188,789
Gross profit .....	1,349,110	1,682,585	2,177,431	1,653,120
Net income .....	591,583	797,086	1,099,205	933,995
Net income per share -				
Basic .....	.29	.38	.53	.45
Diluted .....	.28	.37	.53	.45

### Note 17. Subsequent Events

Subsequent events were evaluated through September 7, 2009, the dates these financial statements were available for issue.

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### Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None

### Item 9A(T). Controls and Procedures

#### Evaluation of 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 Annual Report on Form 10-K. 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.

#### Management's Report on Internal Control Over Financial Reporting

Management of our Company is responsible for establishing and maintaining adequate internal control over financial reporting, as that term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including the principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting using the criteria set forth in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation using the criteria set forth in Internal Control-Integrated Framework, management has concluded that our internal control over financial reporting was effective as of June 30, 2009.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Our report was not subject to attestation by our registered public accounting firm pursuant to temporary rules of the SEC that permit us to provide only management's report in this annual report.

### Item 9B. Other information

None

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### PART III

The information called for by "Item 10. Directors, Executive Officers, and Corporate Governance", "Item 11. Executive Compensation", "Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters", "Item 13. Certain Relationships and Related Transactions, and Director Independence" and "Item 14. Principal Accountant Fees and Services", is hereby incorporated by reference to the Company's Proxy Statement for its Annual Meeting of Shareholders, (scheduled to be held on November 20, 2009) to be filed with the SEC pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended.

### PART IV

#### Item 15. Exhibits, Financial Statement Schedules Signatures

- 3.1 Certificate of incorporation and all amendments thereto (incorporated by reference to Exhibit 3.1 to Espey's Report on Form 10-K for the year ended June 30, 2004 and Report on Form 10-Q for the quarter ended December 31, 2004)
- 3.2 Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 to Espey's Report on Form 8-K dated February 26, 2009)
- 4.1 Amended and Restated Rights Agreement, dated March 31, 1989, as amended February 12, 1999 and December 31, 1999, between Espey Mfg. & Electronics Corp. and Registrar and Transfer Company (incorporated by reference to Espey's Form 8-K dated December 20, 1999)
- 4.2 Description of Capital Stock (incorporated by reference to Espey's Report on Form 8-K dated October 7, 2005)
- 10.1 2000 Stock Option Plan (incorporated by reference to Espey's Definitive Proxy Statement dated December 6, 1999 for the January 4, 2000 Annual Meeting)
- 10.2 Executive Officer contract (incorporated by reference to Exhibit 10.2 to Espey's Report on Form 8-K dated July 27, 2009)
- 10.3 2007 Stock Option and Restricted Stock Plan (incorporated by reference to Espey's Proxy Statement dated October 23, 2007 for the November 30, 2007 Annual Meeting)
- 11.1 Statement re: Computation of Per Share Net income (filed herewith)
- 14.1 Code of ethics (incorporated by reference to Espey's website [www.espey.com](http://www.espey.com))  
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- 23.1 Consent of Rotenberg & Co., LLP (filed herewith)
- 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 (filed herewith)
- 31.2 Certification of the Principal Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange

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Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith)

- 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 (filed herewith)
- 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 (filed herewith)

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S I G N A T U R E S

Pursuant to the requirements of Section 13 and 15 (d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ESPEY MFG. & ELECTRONICS CORP.

/s/Howard Pinsley

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Howard Pinsley  
Chief Executive Officer

Chief Executive Officer  
September 8, 2009

/s/Howard Pinsley

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Howard Pinsley

/s/David O'Neil

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David O'Neil

Treasurer  
(Principal Financial Officer)  
September 8, 2009

/s/Katrina Sparano

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Katrina Sparano

Assistant Treasurer  
(Principal Accounting Officer)  
September 8, 2009

/s/Barry Pinsley

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Barry Pinsley

Director  
September 8, 2009

/s/Seymour Saslow

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Seymour Saslow

Director  
September 8, 2009

/s/Michael W. Wool

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Michael W. Wool

Director  
September 8, 2009

/s/Paul J. Corr

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Paul J. Corr

Director  
September 8, 2009

/s/Alvin O. Sabo

Director



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Alvin O. Sabo

September 8, 2009

/s/Carl Helmetag  
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Carl Helmetag

Director  
September 8, 2009