ESPEY MFG & ELECTRONICS CORP
Form 10-K
September 17, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the fiscal year ended June 30, 2014

Commission File Number I-4383

ESPEY MFG. & ELECTRONICS CORP.

(Exact name of registrant as specified in its charter)

NEW YORK 14-1387171

(State of incorporation) (I.R.S. Employer's Identification No.)

233 Ballston Avenue, Saratoga Springs, New York 12866

(Address of principal executive offices)

518-584-4100

(Registrant's telephone number, including area code)

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

Title of each class	**Name of each exchange on which registered**
Common Stock $.33-1/3 par value	NYSE MKT
Common Stock Purchase Rights	NYSE MKT

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 S 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 S No

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

S Yes £ No

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

S Yes £ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 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 S Smaller reporting company
Indicate by check mark whether the registrant is a shell company.

£ Yes S No

The aggregate market value of the voting stock held by non-affiliates of the registrant was $51,915,281 based upon the closing sale price of $32.64 on the NYSE MKT on December 31, 2013.

At September 16, 2014, there were 2,368,910 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 2014 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.

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” a 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:

- Changing priorities or decreases in the U.S. government’s defense budget (including changes in priorities in response to terrorist threats, improvement of homeland security and general U.S. Government budgetary issues);
- Termination of government contracts due to unilateral government action;
- 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;
- 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. (“Espey”) is a power electronics design and original equipment manufacturing (OEM) company with a long history of developing and delivering highly reliable products for use in military and severe environment applications. All design, manufacturing, and testing is performed in our 150,000+ square foot facility located at 233 Ballston Ave, Saratoga Springs, New York. Espey is classified as a “smaller reporting company” for purposes of the reporting requirements under the Securities Exchange Act of 1934, as amended. Espey’s common stock is publicly-traded on the NYSE MKT under the symbol “ESP.”

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

Espey is ISO 9001:2008 and AS9100:2009 certified. Our primary products are power supplies, power converters, filters, power transformers, magnetic components, power distribution equipment, ups systems, antennas and high power radar systems. The applications of these products include AC and DC locomotives, shipboard power, shipboard radar, airborne power, ground-based radar, and ground mobile power. The Company received AS9100:2009 certification, a quality management system specific to the aerospace industry, in fiscal 2014. Major aerospace manufacturers and suppliers worldwide require compliance to AS9100 as a condition of doing business with them. Obtaining certification will allow the Company to maintain current business and provides an opportunity to expand the Company’s qualification to bid on more work in the aerospace industry.

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

In the fiscal years ended June 30, 2014 and 2013, the Company's total sales were $27,136,919 and $34,298,210, respectively. Sales to three customers accounted for 31%, 16% and 12% of total sales in 2014. Sales to three customers accounted for 33%, 18% and 12% of total sales in 2013. A loss of a significant customer would negatively impact the financial performance of the Company.

Export sales in 2014 and 2013 were approximately $3,030,000 and $2,671,000, respectively. This increase is primarily due to the shipment of transmitter components to a specific customer.

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 4, 2014, the Company's backlog was approximately $34 million. The total backlog at June 30, 2014 was approximately $35.7 million compared to approximately $42.1 million at June 30, 2013. The Company’s total backlog represents the estimated remaining sales value of work to be performed under firm contracts. The funded portion of this backlog at June 30, 2014 is approximately $33.4 million. This includes items that have been authorized and appropriated by Congress and/or funded by the customer. The unfunded backlog is approximately $2.3 million and represents firm multi-year orders for which funding has not yet been appropriated by Congress or funded by our customer. While there is no guarantee that future budgets and appropriations will provide funding for a given program, management has included in unfunded backlog only those programs that it believes are likely to receive funding based on discussions with customers and program status. The unfunded backlog at June 30, 2013 was $114,000. 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 $18 million of orders comprising the June 30, 2014 backlog will be filled during the fiscal year ending June 30, 2015. The minimum of $18 million does not include any shipments, which may be made against orders subsequently received during the fiscal year ending June 30, 2015. The estimate of the June 30, 2014 backlog to be shipped in fiscal 2015 is subject to future events, which may cause the amount of the backlog actually shipped to differ from such estimate.

Our backlog has declined due to several factors. First, the unresolved process for addressing the U.S.'s fiscal imbalances is a risk, not unique to Espey, and is common to all defense contractors. The Congressional sequestration and subsequent budget compromise has established a level of uncertainty associated with large-scale defense cuts and has caused delays in program management including the processing of new orders and request for proposals associated with new procurement.

Moreover, engineering development contracts frequently have an element of uncertainty associated with the status of the applicable defense program, whether it will be approved for ultimate production and the timing of production, and whether the particular program will be funded by Congress. It is not uncommon for there to be a lapse of several years or more between engineering development work and production work. Or, as we have recently observed, production work may be delayed indefinitely or never occur.

In addition to factors affecting the defense industry generally, recently, we have experienced negative developments involving two specific engineering programs which we believed had the potential to result in significant sales for the Company. These programs have been cancelled by the respective customers, resulting in a reduction of the sales backlog by approximately $2.6 million. Further discussion associated with the cancelled contracts is discussed in greater detail in Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in Item 7 below.

Another factor contributing to the decline of the backlog has been our inability, thus far, to convert marketing efforts to potential new customers into awards of business.

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. Espey is also on the eligible list of contractors with the United States Department of Defense and generally is automatically solicited by Defense Department procurement agencies for their needs falling within the major classes of products produced by the Company. In addition, the Company directly pursues opportunities from the United States Department of Defense for prime contracts. Espey contracts with the Federal Government under cage code 20950 as Espey Mfg. & Electronics Corp. and cage code 98675 as Espey Mfg. & Electronics Corp., Saratoga Industries Division.

There is competition in all classes of products manufactured by the Company from divisions of the largest electronic companies, as well as many small companies. The Company's sales do not represent a significant share of the industry's market for any class of its products. The principal methods of competition for electronic products of both a military and industrial nature include, among other factors, price, product performance, the experience of the particular company and history of its dealings in such products. The Company, as well as other companies engaged in supplying equipment for military use, is subject to various risks, including, without limitation, dependence on United States and foreign government appropriations and program allocations, the competition for available military business, and government termination of orders for convenience.

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

Declining federal defense spending has caused new incidents of competition in the industry. Based upon discussions during contract negotiations with our major customers, we believe that many of our competitors are aggressively investing in upfront product design costs and lowering profit margins as a strategic means of maintaining existing business and enhancing market share at the expense of short term profit. This change in the market place has put pressure on the pricing of our current products and will likely result in lower margins on new business and some of our legacy business. In order to compete effectively for new business, we may similarly need to invest in upfront design costs, thereby reducing initial profitability as a means of procuring new long-term programs. Accordingly, we have adjusted our pricing strategy in order to achieve a balance which enables us both to retain repeat programs while being more competitive in bidding on new programs. We continue to refine this strategy as we move forward.

Research and Development

The Company's expenditures for research and development were approximately $93,588 and $60,597 in fiscal 2014 and 2013, 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. A majority of these expenditures relate to research that is required by Espey engineers to support a request for a quotation from a customer having a product-specific custom need usually associated with stringent size and weight requirements.

Employees

The Company had 145 employees as of September 11, 2014. Approximately 40% of these employees are represented by the International Brotherhood of Electrical Workers Local #1799. A new collective bargaining agreement was approved in July 2012. The three-year agreement expires on June 30, 2015. Relations with the Union are considered good.

Government Regulations

Compliance with federal, state and local laws regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, did not in fiscal year 2014, and the Company believes will not in fiscal year 2015, 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. Normally, 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).

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 administrative, 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 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, 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 machine shop and environmental facilities are available to other companies on a contract basis.

Item 3. Legal Proceedings
None

Item 4. Mine Safety Disclosures
Not applicable

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 MKT (symbol "ESP"), the principal market for trading in the common stock, for each quarterly period for the last two fiscal years ended June 30:

2014	High	Low
First Quarter	$28.88	$25.35
Second Quarter	33.89	28.60
Third Quarter	32.64	26.45
Fourth Quarter	28.50	22.44
2013		
First Quarter	$31.00	$22.03
Second Quarter	27.98	22.87
Third Quarter	26.94	24.26
Fourth Quarter	26.49	24.09

Holders

The approximate number of holders of record of the common stock was 88 on September 9, 2014 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 $2.00 per share for the fiscal year ended June 30, 2014 and $1.975 per share for the fiscal year ended June 30, 2013, which included a special dividend of $1.00 per share during each fiscal year. The Board of Directors has authorized the payment of a fiscal 2015 first quarter dividend of $.25 payable September 30, 2014 to shareholders of record on September 25, 2014. Our Board of Directors assesses the Company’s dividend policy periodically. There is no assurance that the Board of Directors will either maintain the amount of the regular cash dividend or declare a special dividend during any future years.

During fiscal 2014, 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, 23,420 shares were sold at prices that ranged from $15.95 a share to $25.10 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 2014 fourth quarter.

The following table sets forth information as of June 30, 2014 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 (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of Securities remaining available for future issuance under equity compensation plan (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	161,555	$22.43	226,925
Equity compensation plans not approved by security holders	--		--
Total	161,555		226,925

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

Management expects revenues in fiscal 2015 to be less than fiscal year 2014 revenues. Expectations are for product mix and margins to remain favorable for fiscal year 2015. During fiscal 2014 new orders received by the Company were approximately $21 million. The total backlog at June 30, 3014 was approximately $35.7 million. It is presently anticipated that a minimum of $18 million of orders comprising the June 30, 2014 backlog will be filled during the fiscal year ending June 30, 2015. The minimum of $18 million does not include any shipments, which may be made against orders subsequently received during the fiscal year ending June 30, 2015. See discussions below for further detail on the customer mix included in the backlog.

In addition to the backlog, the Company currently has outstanding opportunities representing in excess of $21 million in the aggregate for both repeat and new programs. The outstanding quotations encompass various new and previously manufactured power supplies, transformers, and subassemblies. However, there can be no assurance that the Company will acquire any of the anticipated orders described above, many of which are subject to allocations of the United States defense spending and factors affecting the defense industry and military procurement generally.

Revenues, backlog and outstanding opportunities have declined and we believe may continue to trend down in the foreseeable future due to several ongoing factors discussed in detail in the Sales Backlog and Marketing and Competition sections contained in Item 1 above. Management continues to evaluate our sales strategy including the professional and technical resources necessary to keep pace with the changing market conditions and needs of our customers. The Company has added to and re-aligned current sales and engineering resources, in order to focus on penetrating opportunities with new and existing customers. The Company continues quoting new customers for programs of varying sizes.

Three significant customers represented 59% and 63% of the Company’s total sales in fiscal 2014 and 2013, respectively. These sales are in connection with multiyear programs in which the Company is a significant subcontractor. The June 30, 2014 backlog of $35.7 million includes orders from two customers that represent 50% and 16% of the total backlog. This high concentration level with two customers presents significant risk. A loss of one of these customers or programs related to these customers could significantly impact the Company. Historically, a small number of customers have accounted for a large percentage of the Company’s total sales in any given fiscal year. Management continues to pursue opportunities with current and new customers with an overall objective of lowering the concentration of sales, mitigating excessive reliance upon a single major product of a particular program and minimizing the impact of the loss of a single significant customer. Management continues to evaluate its business development functions and potential revised courses of action in order to diversify its customer base.

Management, along with the Board of Directors, continues to evaluate the need and use of the Company’s working capital. Capital expenditures are expected to be approximately $200,000 for fiscal 2015. Expectations are that the working capital will be required to fund orders, dividend payments, and general operations of the business. From time to time, management along with the Mergers and Acquisitions Committee of the Board of Directors examine opportunities involving acquisitions or other strategic options, including buying certain products or product lines. The criteria for consideration are synergies with the Company’s existing product base and accretion to earnings.

Results of Operations

Net sales for fiscal years ended June 30, 2014 and 2013, were $27,136,919 and $34,298,210, respectively, a 21% decrease. This decrease can be attributed to the contract specific nature of the Company’s business and the timing of deliveries on these contracts. More specifically, power supply and transformer sales decreased by $6.5 million and $3 million, respectively, offset by an increase in electro-mechanical and spare parts shipments of $2.5 million.

For the fiscal years ended June 30, 2014 and 2013 gross profits were $4,531,246 and $10,699,569, respectively. Gross profit as a percentage of sales decreased to 16.7% for fiscal 2014, down from 31.2% in fiscal 2013. 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 decrease in gross profit in fiscal 2014 compared to fiscal 2013 was primarily driven by two factors. These factors were a sales decrease caused by a declining backlog, and losses incurred on two engineering design programs in which the Company had been investing with the objective of developing future sales for follow-on production orders. As to both of these programs, we are either certain or believe that no sales will materialize during the next several years.

In one instance, we experienced engineering problems (in part attributable to Espey) which caused the customer to look for alternative solutions. The impact of the program cancellation on total gross profit for fiscal 2014 was a decrease by $263,000. In a separate program, we encountered engineering problems in the final stages of a significant contract for three separate parts for a military ground combat vehicle. The program required complex electrical designs, and we were unsuccessful in delivering all required compliant prototypes to the customer by the agreed upon contract dates. Our customer would not give us any more time to complete these units as they were required to close out the prime contract by the U.S. Government. The program itself posed increased risk related to follow-on production orders as it was announced during fiscal 2014 that production funding for this vehicle was cut by the Department of Defense with no certainty as to whether the program would be revived and funded at a future date. The impact of the program cancellation on gross profit for fiscal 2014 was a decrease of $3.6 million. Losses affecting gross profit were favorably offset by the reduction of a contract audit reserve of $319,000.

Selling, general and administrative expenses were $3,214,050 for the fiscal year ended June 30, 2014, an increase of $296,910, or 10% as compared to the prior year. The increase for fiscal 2014 relates primarily to severance costs incurred for terminated employees and an increase in salary expense associated with new personnel hired during fiscal 2014.

Employment of full time equivalents at June 30, 2014 was 150 people compared with 170 people at June 30, 2013.

Other income for the fiscal years ended June 30, 2014 and 2013 was $148,753 and $83,758, respectively. The increase in other income is due an increase in interest income, scrap and miscellaneous income.

The effective income tax rate was 20.3% in fiscal 2014 and 29.3% in fiscal 2013. The effective tax rate is less than the statutory tax rate mainly due to the benefit the Company receives on its “qualified production activities” under The American Jobs Creation Act of 2004 and the benefit derived from the dividends paid on allocated ESOP shares.

Net income for fiscal 2014, was $1,167,885 or $.52 and $.51 per share, basic and diluted, respectively, compared to net income of $5,562,425 or $2.52 and $2.48 per share, basic and diluted, respectively, for fiscal 2013. The decrease in net income per share was primarily due to lower sales, lower gross profits, and higher selling, general, and administrative expenses.

Liquidity and Capital Resources

The Company's working capital is an appropriate indicator of the liquidity of its business, and during the past two fiscal years, the Company, when possible, has funded all of its operations with cash flows resulting from operating activities and when necessary from its existing cash and investments. The Company did not borrow any funds during the last two fiscal years. Management has available a $3,000,000 line of credit to help fund further growth or working capital needs, if necessary, but does not anticipate the need for any borrowed funds in the foreseeable future.

The Company's working capital as of June 30, 2014 and 2013 was $27,251,483 and $29,591,453, respectively. During the three months ended June 30, 2014 and 2013 the Company did not repurchase any shares of its common stock. During the fiscal year ended June 30, 2014 the Company did not repurchase any shares of its common stock. During the fiscal year ended June 30, 2013 the Company repurchased 5,753 shares 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 $150,020. Under existing authorizations from the Company's Board of Directors, as of June 30, 2014, management is authorized to purchase an additional $1,706,248 million of Company stock.

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

	2014	2013
Net cash provided by operating activities	$5,387,543	$3,285,630
Net cash used in investing activities	(1,705,547)	(990,225)
Net cash used in financing activities	(4,013,733)	(3,930,201)

Net cash provided by operating activities fluctuates between periods primarily as a result of differences in net income, level of sales, the timing of the collection of accounts receivable, purchase of inventory and payments of accounts payable. Net cash used in investing activities increased in fiscal 2014 primarily due to investments in capital equipment and a net increase in purchase of investment securities offset by the maturity of investment securities. The increase in cash used in financing activities is due primarily to dividends paid on common stock offset by a decrease in proceeds received from exercised stock options.

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

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 2014 and fiscal 2013, the Company expended $709,972 and $322,507, respectively, for plant improvements and new equipment. The Company has budgeted approximately $200,000 for new equipment and plant improvements in fiscal 2015. Management anticipates that the funds required will be available from current operations.

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.

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.

We have audited the accompanying balance sheets of Espey Mfg. & Electronics Corp. as of June 30, 2014 and 2013, and the related statements of comprehensive income, changes in stockholders’ equity, and cash flows for each of the years in the two-year period ended June 30, 2014. 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, 2014 and 2013, and the results of its operations and its cash flows for each of the years in the two-year period ended June 30, 2014 in conformity with accounting principles generally accepted in the United States of America.

/s/ EFP Rotenberg, LLP

EFP Rotenberg, LLP

Rochester, New York

September 17, 2014

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Espey Mfg. & Electronics Corp.

Balance Sheets

June 30, 2014 and 2013

	2014	2013
ASSETS		
Cash and cash equivalents	$9,556,891	9,888,628
Investment securities	4,910,893	3,892,968
Trade accounts receivable, net	3,194,678	7,204,226
Income tax receivable	943,234	—
Inventories:		
Raw materials	1,616,990	1,607,112
Work-in-process	792,618	607,165
Costs related to contracts in process, net of progress payments of $142,616 in 2014 and $146,916 in 2013	8,201,642	9,159,493
Total inventories	10,611,250	11,373,770
Deferred tax asset	324,823	419,093
Prepaid expenses and other current assets	177,776	315,736
Total current assets	29,719,545	33,094,421
Property, plant and equipment, net	2,678,901	2,421,332
Loan receivable	—	25,194
Total assets	$32,398,446	$35,540,947
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	$727,281	$1,273,142
Accrued expenses:		
Salaries, wages and commissions	413,989	370,554
Vacation	693,286	748,040
Other	579,953	629,878
Payroll and other taxes withheld and accrued	53,553	50,891
Income taxes payable	—	430,463
Total current liabilities	2,468,062	3,502,968
Deferred tax liability	283,439	195,385
Total liabilities	2,751,501	3,698,353
Common stock, par value $.33-1/3 per share Authorized 10,000,000 shares; Issued 3,029,874 shares in 2014 and 2013. Outstanding 2,368,110 and 2,344,690 in 2014 and 2013, respectively (includes 97,500 and 116,666 Unearned ESOP Shares)	1,009,958	1,009,958
Capital in excess of par value	16,429,220	15,780,009

Accumulated other comprehensive (loss) income	(1,437)	412
Retained earnings	20,946,940	24,260,121
	38,384,681	41,050,500
Less: Unearned ESOP shares	(1,408,872)	(1,685,827)
Cost of 661,764 and 685,184 shares of common stock in treasury in 2014 and 2013, respectively	(7,328,864)	(7,522,079)
Total stockholders' equity	29,646,945	31,842,594
Total liabilities and stockholders' equity	$32,398,446	$35,540,947

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

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Espey Mfg. & Electronics Corp.

Statements of Comprehensive Income

Years ended June 30, 2014 and 2013

	2014	2013
Net sales	$27,136,919	$34,298,210
Cost of sales	22,605,673	23,598,641
Gross profit	4,531,246	10,699,569
Selling, general and administrative expenses	3,214,050	2,917,140
Operating income	1,317,196	7,782,429
Other income		
Interest and dividend income	40,612	35,813
Other	108,141	47,945
Total other income	148,753	83,758
Income before income taxes	1,465,949	7,866,187
Provision for income taxes	298,064	2,303,762
Net income	$1,167,885	$5,562,425
Other comprehensive income, net of tax:		
Unrealized loss on investment securities	(1,849)	(1,065)
Total comprehensive income	$1,166,036	$5,561,360
Net income per share:		
Basic	$0.52	$2.52
Diluted	$0.51	$2.48
Weighted average number of shares outstanding:		
Basic	2,245,222	2,206,937
Diluted	2,285,535	2,242,648

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, 2014 and 2013

	Outstanding Shares	Common Amount	Capital in Excess of Par Value	Accumulated Other Comprehensive Income (Loss)	Retained Earnings
Balance as of June 30, 2012	2,320,822	$1,009,958	$15,093,512	$ 1,477	$