ESPEY MFG & ELECTRONICS CORP
Form 10QSB
February 12, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-QSB

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

For the Quarterly Period Ended December 31, 2006

[ ] TRANSISTION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from __________ to __________

Commission File Number I-4383

ESPEY MFG. & ELECTRONICS CORP.
(Exact name of registrant as specified in charter)

NEW YORK	14-1387171
(State of Incorporation)	(I.R.S. Employer's Identification No.)

233 Ballston Avenue, Saratoga Springs, New York 12866
(Address of principal executive offices)

Issuer's telephone number, including area code 518-584-4100

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES [X] NO [ ]

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

Class	Outstanding at February 12, 2007
Common stock, $.33-1/3 par value	2,319,796 shares

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

ESPEY MFG. & ELECTRONICS CORP.
Quarterly Report on Form 10-QSB

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PART I: FINANCIAL INFORMATION

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

	December 31, 2006
ASSETS:	
Cash and cash equivalents	$ 8,117,693
Short term investments	4,224,000
Trade accounts receivable, net	3,012,793
Other receivables	3,473
Inventories:	
Raw materials and supplies	1,849,482
Work-in-process	2,245,619
Costs relating to contracts in process, net of advance	

payments of $309,285 at December 31, 2006	8,479,403
Total inventories	12,574,504
Deferred income taxes	170,961
Prepaid expenses and other current assets	588,897
Total current assets	28,692,321
Property, plant and equipment, net	2,835,926
Total assets	$ 31,528,247
LIABILITIES AND STOCKHOLDERS' EQUITY:	
Accounts payable	$ 789,391
Accrued expenses:	
Salaries, wages and commissions	140,997
Vacation	497,450
ESOP payable	147,342
Other	55,105
Payroll and other taxes withheld and accrued	27,067
Income taxes payable	42,501
Total current liabilities	1,699,853
Deferred income taxes	196,383
Total liabilities	1,896,236
Common stock, par value $.33-1/3 per share Authorized 10,000,000 shares; issued 3,029,874 shares on December 31, 2006. Outstanding 2,313,489 (includes 261,667 Unearned ESOP Shares) on December 31, 2006	1,009,958
Capital in excess of par value	12,659,396
Retained earnings	26,144,992
Less: Unearned ESOP Shares	(3,961,079)
Cost of 716,385 Treasury shares on December 31, 2006	(6,221,256)
Total stockholders' equity	29,632,011
Total liabilities and stockholders' equity	$ 31,528,247

See accompanying notes to the financial statements.

ESPEY MFG. & ELECTRONICS CORP.
Statements of Income (Unaudited)
Three and Six Months Ended December 31, 2006 and 2005

	Three Months		Six Months	
	2006	2005	2006	2005
Net sales	$ 6,119,320	$ 5,056,083	$12,191,226	$ 9,616,657
Cost of sales	4,861,099	4,108,723	9,535,697	7,789,007
Gross profit	1,258,221	947,360	2,655,529	1,827,650
Selling, general and administrative expenses	712,743	666,440	1,439,723	1,336,159
Operating income	545,478	280,920	1,215,806	491,491
Other income (expense)				
Interest and dividend income	149,878	110,976	295,389	209,910
Other	30,725	(5,614)	34,350	(8,437)
	180,603	105,362	329,739	201,473
Income before income taxes	726,081	386,282	1,545,545	692,964
Provision for income taxes	246,170	112,022	522,584	200,960
Net income	$ 479,911	$ 274,260	$ 1,022,961	$ 492,004
Net income per share:				
Basic	$ .23	$ 0.14	$ .50	$ 0.24
Diluted	$ .23	$ 0.13	$ .49	$ 0.24
Weighted average number of shares outstanding:				
Basic	2,047,803	2,010,791	2,040,909	2,010,779
Diluted	2,071,693	2,049,020	2,066,015	2,050,590
Dividends per share:	$ .13	$ 0.0875	$ .26	$ 0.1625

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

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.
Statements of Cash Flows (Unaudited)

Six Months Ended December 31, 2006 and 2005

	December 31	
	2006	
Cash Flows From Operating Activities:		
Net income	$ 1,022,961	$
Adjustments to reconcile net income to net cash provided by operating activities:		
Tax effect on stock options	49,697	
Stock option compensation	76,020	
Depreciation	243,022	
ESOP compensation expense	218,625	
Loss on disposal of assets	4,376	
Deferred income tax	(36,262)	
Changes in assets and liabilities:		
Decrease (Increase) in trade receivables, net	1,200,435	
Decrease (Increase) in other receivables	3,411	
Increase in inventories	(170,125)	
Increase in prepaid expenses and other current assets	(34,770)	
Increase in accounts payable	173,805	
Increase in accrued salaries, wages and commissions	12,990	
Decrease in vacation accrual	(47,973)	
Increase in other accrued expenses	3,705	
(Decrease) Increase in payroll & other taxes withheld and accrued	(13,530)	
Decrease in income taxes payable	(611,717)	
Decrease in ESOP payable	(71,284)	
Net cash provided by (used in) operating activities	2,023,386	
Cash Flows From Investing Activities:		
Unearned ESOP Shares	--	(4
Additions to property, plant & equipment	(200,871)	
Proceeds on sale of assets, net	--	
Purchase of short term investments	(2,400,000)	(3
Maturity of short term investments	2,112,000	2
Net cash used in investing activities	(488,871)	(5
Cash Flows From Financing Activities:		
Sale of treasury stock	--	4
Dividends on common stock	(529,914)	
Purchase of treasury stock	(110,203)	
Proceeds from exercise of stock options	150,680	
Net cash (used in) provided by financing activities	(489,437)	3
Increase (Decrease) in cash and cash equivalents	1,045,078	(2
Cash and cash equivalents, beginning of period	7,072,615	9
Cash and cash equivalents, end of period	8,117,693	7
Supplemental disclosures of cash flow information:		
Income Taxes Paid	$ 1,121,159	$

Non-cash investing and financing activities:

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

See accompanying notes to the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.
Notes to Financial Statements (Unaudited)

Note 1. Basis of Presentation

In the opinion of management the accompanying unaudited financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the results for such periods. The results for any interim period are not necessarily indicative of the results to be expected for the full fiscal year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles have been condensed or omitted. These financial statements should be read in conjunction with the Company's most recent audited financial statements included in its 2006 Form 10-KSB.

Note 2. Net Income per Share

Basic net income per share excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the income of the Company. As Unearned ESOP shares are released or committed-to-be-released the shares become outstanding for earnings-per-share computations.

Note 3. Stock Based Compensation

Prior to July 1, 2006, the Company accounted for its stock-based compensation plan under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB Opinion No. 25") and related interpretations, as permitted by the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. Accordingly, no stock-based compensation expense was recognized in the Statement of Income for the three and six months ended December 31, 2005, as all options granted under the Company's stock-based employee compensation plan had an exercise price equal to the market value of the underlying common stock on the date of grant. As permitted by SFAS No. 123, stock-based compensation expense was included as a pro forma disclosure in the Notes to the Company's financial statements for the three and six months ended December 31, 2005.

Effective July 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), Share-Based Payment, using the modified prospective transition method. Under that transition method, compensation cost

recognized during the three and six months ended December 31, 2006 includes compensation expense for all stock-based compensation awards granted prior to, but not yet vested as of July 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123. Results for prior periods have not been restated, as allowed for under the modified prospective transition method. No new grants have been awarded since July 1, 2006.

Total stock-based compensation expense recognized in the Statement of Income for the three and six months ended December 31, 2006, was $36,831 and $76,020, respectively, before income taxes. The related total deferred tax benefit was approximately $2,923 and $5,992, for the three and six months ended December 31, 2006, respectively. Prior to the adoption of SFAS No. 123(R), the Company presented all tax benefits for deductions resulting from the exercise of stock options as operating cash flows in the Statements of Cash Flows. SFAS No. 123(R) requires the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options to be classified and reported as both an operating cash outflow and a financing cash inflow on a prospective basis upon adoption.

As of December 31, 2006, there was approximately $153,609 of unrecognized compensation cost related to stock option awards that is expected to be recognized as expense over a period of 1.5 years.

The 2000 Stock Option Plan is the Company's only stock option 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 to satisfy option grants are issued from Treasury stock. Options authorized for issuance under the 2000 Stock Option Plan totaled 275,300. As of December 31, 2006, of the options authorized for issuance, 124,000 were granted and are outstanding, 51,000 of which are vested and exercisable. Options available for future grants at December 31, 2006 total 103,800.

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 stock-based employee compensation for the three and six months ended December 31, 2006:

	Three Months Ended December 31, 2006	Six Months Ended December 31, 2006
Dividend yield	2.10%	2.36%
Expected stock price volatility	22.41%	21.72%
Risk-free interest rate	4.49%	4.35%
Expected option life (in years)	5.5	5.4
Weighted average fair value per share of options granted during the period	--	--

The Company pays dividends quarterly and does plan 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 the safe harbor calculation under SFAS No. 123.

The following table illustrates the effect on net income per share for the three and six months ended December 31, 2005 as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation:

	Three Months Ended December 31, 2005	Six Months Ended December 31, 2005
Net income, as reported	$ 274,260	$ 492,004
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related income taxes	(20,926)	(25,784)
Pro forma net income	$ 253,334	$ 466,220
Income per share:		
Basic - as reported	$ .14	$ .24
Basic - pro forma	$ .13	$ .23
Diluted - as reported	$ .13	$ .24
Diluted - pro forma	$ .12	$ .23

The table below outlines the weighted average assumptions as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation for the three and six months ended December 31, 2005:

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	Three Months Ended December 31, 2005	Six Months Ended December 31, 2005
Dividend yield	2.46%	2.46%
Expected stock price volatility	23.26%	23.26%
Risk-free interest rate	4.00%	4.00%
Expected option life (in years)	5.0	5.0
Weighted average fair value per share of options granted during the period	--	--

The following table summarizes stock option activity during the six months ended December 31, 2006:

	Employee Stock Options Plan		
	Number of Shares Subject To Option	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Balance at July 1, 2006	146,200	$14.02	8
Granted	--	--	--

Exercised	(15,000)	10.05	
Forfeited or expired	(7,200)	13.39	
Balance at December 31, 2006	124,000	14.53	8
Exercisable at December 31, 2006	51,000	10.15	6.5

The intrinsic value of stock options exercised was $62,170, during the six months ended December 31, 2006. The intrinsic value of stock options outstanding and exercisable as of December 31, 2006 was $436,975.

Note 4. Commitments and Contingencies

The Company has entered into standby letters of credit agreements with financial institutions primarily relating to the guarantee of future performance on certain contracts. Contingent liabilities on outstanding standby letters of credit agreements aggregated $119,650 at December 31, 2006. The Company does not expect to fund any of the amounts under the standby letters of credit. As a government contractor, the Company is continually subject to audit by various agencies of the U.S. Government to determine compliance with various procurement laws and regulations. As a result of such audits and as part of normal business operations of the Company, various claims and charges can be asserted against the Company. It is not possible at this time to predict the outcome of any such actions. There are no pending claims against the Company.

Note 5. Recently Issued Accounting Standards

In July 2006, the FASB issued Interpretation No. ("FIN") 48, Accounting for Uncertainty in Income Taxes--An Interpretation of FASB Statement No. 109, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In particular, this interpretation requires uncertain tax positions to be recognized only if they are "more-likely-than-not" to be upheld based on their technical merits. Additionally, the measurement of the tax position will be based on the largest amount that is determined to have greater than a 50% likelihood of realization upon ultimate settlement. Any resulting cumulative effect of applying the provisions of FIN 48 upon adoption would be reported as an adjustment to the beginning balance of retained earnings and an adjustment to tax liabilities in the period of adoption. FIN 48 will be effective beginning July 1, 2007. The adoption of FIN 48 will not have a material effect on the Company's financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standard ("SFAS") No. 157, Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies to other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those

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years. The Company is currently evaluating the effect of the guidance contained in SFAS 157 and does not expect the implementation to have a material effect on the Company's financial statements.

Note 6. Employee Stock Ownership Plan

The Company sponsors a leveraged employee stock ownership plan (the "ESOP") that

covers all nonunion employees who work 1,000 or more hours per year and are employed on June 30.

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 $111,375 for the quarter ended December 31, 2006 and $218,625 for the six-month period ending December 31, 2006. The ESOP shares as of December 31, 2006 were as follows:

Allocated Shares	436,492
Committed-to-be-released shares	12,500
Unreleased shares	261,667
Total shares held by the ESOP	710,659
Fair value of unreleased shares at December 31, 2006	$ 4,898,406

Note 7. Stock Split

On December 30, 2005, the Company effected a one-for-one stock split in the form of a dividend of one share of common stock for each share of common stock outstanding. The Company also allocated to treasury an additional share for each share being held as a treasury share. All references to the number of common shares, shares related to the Company's stock option plan, as well as per share data in the accompanying financial statements, have been adjusted to reflect the stock split on a retroactive basis. As a result of the stock split, common stock was increased and retained earnings was decreased by $504,979.

Item 2. Management's Discussion and Analysis or Plan of Operation

Overview

Espey Mfg. & Electronics Corp. (the "Company") located in Saratoga Springs, New York, is engaged principally in the development, design, production and sale of specialized electronic power supplies, a wide variety of transformers and other types of iron-core components, and electronic system components. In some cases, the Company manufactures such products in accordance with pre-developed mechanical and electrical requirements ("build to print"). In other cases, the Company is responsible for both the overall design and manufacture of the product. The Company does not generally manufacture standardized components and does not have a product line. The products manufactured by the Company find application principally in (i) shipboard and land based radar, (ii) locomotives, (iii) aircraft, (iv) short and medium range communication systems, (v) navigation systems, and (vi) land-based military vehicles.

Business is solicited from large industrial manufacturers and defense companies,

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

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

Management is optimistic about the future of the Company. In the first half of fiscal 2007, the Company received approximately $8.2 million in new orders. These orders include both follow-on production quantities for mature products and engineering development orders which will enable the Company to utilize its engineering expertise in developing new customer specific products. Some of these products, once developed, will be produced in the Company's manufacturing facility and are expected to provide large production order quantities over several years. These orders are in line with the Company's strategy of getting involved in long-term high quantity military and industrial products.

The sales backlog of approximately $33.7 million at December 31, 2006 gives the Company a solid base of future sales and, therefore, management continues to expect an increase in sales during fiscal 2007 as compared to fiscal 2006. In addition to the backlog, the Company currently has outstanding quotations representing in excess of $31 million in the aggregate for both repeat and new programs. New orders received in the first half of fiscal 2007 were approximately $8.2 million compared to approximately $20.6 million in the first half of fiscal 2006. Many potential orders are currently being discussed and negotiated with our customers and management expects to book several orders in the second half of the fiscal year.

The outstanding quotations encompass various new and previously manufactured power supplies, transformers, and subassemblies. However, there can be no assurance that the Company will acquire any or all of the anticipated orders described above, many of which are subject to allocations of the United States defense spending and factors affecting the defense industry and military procurement generally.

The total backlog for the Company of $33.7 million at December 31, 2006, down $9.0 million as compared to December 31, 2005, represents the estimated remaining sales value of work to be performed under firm contracts. The funded portion of this backlog at December 31, 2006 is approximately $29.4 million. This includes items that have been authorized and appropriated by Congress and/or funded by the customer. The unfunded backlog is approximately $4.3 million and represents firm multi-year orders for which funding has not yet been appropriated by

Congress. While there is no guarantee that future budgets and appropriations will provide funding for a given program, management has included in unfunded backlog only those programs that it believes are likely to receive funding. The unfunded backlog at December 31, 2005 was approximately $8.6. The backlog at December 31, 2006, as discussed above, includes significant orders for military and industrial power supplies, and contracts to manufacture certain customer products in accordance with pre-engineered requirements.

Management, along with the Board of Directors, continues to evaluate the need and use of the Company's working capital. Expectations are that the working capital will be required to fund the increase in orders over the next several quarters, dividend payments, and general operations of the business. Also, the Mergers and Acquisitions Committee of the Board of Directors continues to evaluate potential strategic options on a periodic basis.

Critical Accounting Policies and Estimates

We believe our most critical accounting policies include revenue recognition and estimates to completion.

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

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

Results of Operations

Net sales for the three months ended December 31, 2006 were $6,119,320 as compared to $5,056,083 for the same period in 2005, representing a 21.0% increase. Net sales for the six months ended December 31, 2006 were $12,191,226 as compared to $9,616,657 for the same period in 2005, representing a 27% increase. Generally, these increases can be attributed to the contract specific nature of the Company's business. The Company continues to deliver product on its single largest order for power supplies. The increase in sales for the three and six months ended December 31, 2006 is largely attributable to an increase in shipments to two customers for power supplies and transformers.

The primary factor in determining gross profit and net income is product mix. The gross profits on mature products and build to print contracts are higher than with respect to the products, which are still in the engineering development stage or in the early stages of production. In any given accounting period the mix of product shipments between higher margin mature programs and less mature programs including loss contracts, has a significant impact on gross profit and net income.

For the three months ended December 31, 2006 and 2005 gross profits were $1,258,221 and $947,360, respectively. Gross profit as a percentage of sales was 20.6% and 18.7%, for the three months ended December 31, 2006 and 2005, respectively. For the six months ended December 31, 2006 and 2005 gross profits were $2,655,529 and $1,827,650, respectively. Gross profit as a percentage of

sales was 21.8% and 19.0%, for the six months ended December 31, 2006 and 2005, respectively. The improved gross profit percentage in the three and six months ended December 31, 2006, relates to a favorable mature product mix and lower overhead expenses, offset partially by stock option expense. 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 December 31, 2006 was 173.5 compared to 175 people at December 31, 2005.

Selling, general and administrative expenses were $712,743 for the three months ended December 31, 2006, an increase of $46,303 compared to the three months ended December 31, 2005. Selling, general and administrative

expenses were $1,439,723 for the six months ended December 31, 2006, an increase of $103,564 compared to the six months ended December 31, 2005. The increase is primarily due to stock option expense and an increase in selling expenses.

Other income for three and six months ended December 31, 2006 increased as compared to the three months ended December 31, 2005 due to increased interest income on the Company's cash and cash equivalents and short-term investments due to higher interest rates. The Company does not believe that there is a significant risk associated with its investment policy, since at December 31, 2006 all of the investments are primarily represented by short-term liquid investments including certificates of deposit and money market accounts.

The effective income tax rate at December 31, 2006 and 2005 was 33.8% and 29.0%, respectively. The effective tax rate is less than the statutory tax rate mainly due to the foreign exportation benefit the Company receives on its international sales, the Qualified Production Activities benefit, and the benefit derived from the ESOP dividends paid on allocated shares.

Net income for the three months ended December 31, 2006, was $479,911 or $.23 per share, both basic and diluted, compared to $274,260 or $.14 and $.13 per share, basic and diluted, for the three months ended December 31, 2005. Net income for the six months ended December 31, 2006, was $1,022,961 or $.50 and $.49 per share, basic and diluted, compared to $492,004 or $.24 per share, both basic and diluted, for the six months ended December 31, 2005. The increase in net income per share was due to improved gross profit as a percentage of sales, offset partially by the increase in selling, general and administrative expenses.

Liquidity and Capital Resources

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

The Company's working capital as of December 31, 2006 was approximately $26.8 million. During the three months ended December 31, 2006 and 2005 the Company repurchased 4,307 and 14,462 shares, respectively, of its common stock from the Company's Employee Retirement Plan and Trust ("ESOP"), for a total purchase price of $79,077 and $262,125, respectively. During the six months ended December 31, 2006 and 2005 the Company repurchased 6,073 and 38,746 shares, respectively, of its common stock for a total purchase price of $110,202 and

$679,809, respectively. Under existing authorizations from the Company's Board of Directors, as of December 31, 2006, management is authorized to purchase an additional $889,798 million of Company stock.

	Six Months Ended December 31, 2006	2005
Net cash provided by (used in) operating activities	$2,023,386	$ (325,582)
Net cash used in investing activities	(488,871)	(5,553,408)
Net cash (used in) provided by financing activities	(489,437)	3,532,588

Net cash provided by operating activities fluctuates between periods primarily as a result of differences in net income, the timing of the collection of accounts receivable, purchase of inventory, level of sales and payment of accounts payable. Net cash used in investing activities decreased in the first half of fiscal 2007 due to the decrease in purchases of short-term investments and the ESOP transaction which occurred in the prior year. The decrease in cash provided by financing activities is due primarily to decrease in purchases of treasury stock and the ESOP transaction which occurred in the prior year.

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

During the six months ended December 31, 2006 and 2005, the Company expended $200,871 and $258,908, respectively, for plant improvements and new equipment. The Company has budgeted approximately $500,000 for

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new equipment and plant improvements in fiscal 2007. Management presently anticipates that the funds required will be available from current operations.

The Company has entered into standby letters of credit agreements with financial institutions primarily relating to the guarantee of future performance on certain contracts. Contingent liabilities on outstanding standby letters of credit agreements aggregated $119,650 at December 31, 2006. The Company does not expect to fund any of the amounts under the standby letters of credit.

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

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

circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made.

Item 3. Controls and Procedures

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

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

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PART II: Other Information and Signatures

Item 1. Legal Proceedings

None

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

(a) None

(c) Securities Repurchased

Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Maximum (or Appr Dollar V of Sha that Ma Be Purc Under th or Progr
December 1 to December 31, 2006	4,307	$18.36	4,307	$889,

(1) Pursuant to a prior Board of Directors authorization, as of December 31, 2006 the Company can repurchase up to $889,798 of its common stock pursuant to an ongoing plan.

Item 3 Defaults on Senior Securities

None

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

(a) The Company's Annual Meeting of Shareholders (the "Annual Meeting") was held on November 20, 2006.

(b) Howard Pinsley, Alvin Sabo and Carl Helmetag were re-elected as Class A directors each to serve for a three-year term. Continuing as directors after the Annual Meeting were:

Class A (term expiring 2009):	Howard Pinsley Alvin Sabo Carl Helmetag
Class B (term expiring 2007):	Barry Pinsley Seymour Saslow
Class C (term expiring 2008):	Paul J. Corr Michael W. Wool

(c) The following matters were voted upon at the annual meeting:

The election of three Class A directors. The votes were cast as follows:

Nominee:	Voted For:	Voted Against or Withheld:	Brok
Howard Pinsley	1,844,151	284,027	
Alvin Sabo	2,075,064	53,114	
Carl Helmetag	2,072,944	55,234	

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Ratification of Rotenberg & Company LLP, as independent auditors for the Corporation for the fiscal year ending June 30, 2007. The votes were cast as follows:

Shares in favor	2,111,861
Shares against	1,740
Abstentions	14,576
Broker non-votes	0

Item 5. Other Information

None

Item 6. Exhibits

(a) Exhibits

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

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

S I G N A T U R E S

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

ESPEY MFG. & ELECTRONICS CORP.

/s/ Howard Pinsley

Howard Pinsley, President and
Chief Executive Officer

/s/ David O'Neil

David O'Neil, Treasurer and
Principal Financial Officer

February 12, 2007

Date