

ESPEY MFG & ELECTRONICS CORP
Form 10-Q
November 13, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2018

Commission File Number I-4383

ESPEY MFG. & ELECTRONICS CORP.

(Exact name of registrant as specified in its charter)

NEW YORK

(State of incorporation)

14-1387171

(I.R.S. Employer's Identification No.)

233 Ballston Avenue, Saratoga Springs, New York 12866

(Address of principal executive offices)

518-245-4400

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(Registrant's telephone number, including area code)

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

S Yes £ No

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

S Yes £ No

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

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

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

£ Yes S No

At November 13, 2018, there were 2,396,323 shares outstanding of the registrant's Common stock, \$.33-1/3 par value.

ESPEY MFG. & ELECTRONICS CORP.

Quarterly Report on Form 10-Q

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PART I: FINANCIAL INFORMATION

ESPEY MFG. & ELECTRONICS CORP.

Balance Sheets

September 30, 2018 (Unaudited) and June 30, 2018

	September 30, 2018	June 30, 2018
ASSETS:		
Cash and cash equivalents	\$6,337,621	\$4,298,796
Investment securities	7,445,292	11,520,706
Trade accounts receivable, net of allowance of \$3,000	5,795,529	4,377,726
Income tax receivable	289,197	161,975
Inventories:		
Raw materials	1,645,216	1,562,581
Work-in-process	793,143	966,342
Costs related to contracts in process	11,324,865	8,880,003
Total inventories	13,763,224	11,408,926
Prepaid expenses and other current assets	277,725	1,292,575
Total current assets	33,908,588	33,060,704
Property, plant and equipment, net	4,247,760	3,758,637
Total assets	\$38,156,348	\$36,819,341
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Accounts payable	\$2,581,373	\$1,822,597
Accrued expenses:		
Salaries and wages	587,424	529,005
Vacation	710,997	707,612
ESOP payable	101,361	—
Dividend payable	2,995,404	—
Other	158,717	104,663
Payroll and other taxes withheld	68,565	53,435
Contract liabilities	102,924	102,924
Total current liabilities	7,306,765	3,320,236
Deferred tax liabilities	63,062	17,693
Total liabilities	7,369,827	3,337,929
Commitments and contingencies (See Note 5)		
Common stock, par value \$.33-1/3 per share		
Authorized 10,000,000 shares; Issued 3,029,874 shares		
as of September 30, 2018 and June 30, 2018. Outstanding		

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2,396,323 and 2,387,124 as of September 30, 2018 and June 30, 2018, respectively (includes 25,416 and 29,166 Unearned ESOP shares, respectively)	1,009,958	1,009,958
Capital in excess of par value	18,363,293	18,201,691
Accumulated other comprehensive loss	(5,002)	(6,349)
Retained earnings	19,482,668	22,416,400
	38,850,917	41,621,700
Less: Unearned ESOP shares	(421,453)	(421,453)
Cost of 633,551 and 642,750 shares of common stock in treasury as of September 30, 2018 and June 30, 2018, respectively	(7,642,943)	(7,718,835)
Total stockholders' equity	30,786,521	33,481,412
Total liabilities and stockholders' equity	\$38,156,348	\$36,819,341

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

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ESPEY MFG. & ELECTRONICS CORP.

Statements of Comprehensive Income (Unaudited)

Three Months Ended September 30, 2018 and 2017

	September 30, 2018	September 30, 2017
Net sales	\$8,337,399	\$7,496,423
Cost of sales	7,344,465	6,035,269
Gross profit	992,934	1,461,154
Selling, general and administrative expenses	1,009,544	878,820
Operating (loss) income	(16,610)	582,334
Other income:		
Interest income	52,399	31,224
Other	23,671	10,172
Total other income	76,070	41,396
Income before provision for income taxes	59,460	623,730
(Benefit) provision for income taxes	(2,211)	180,966
Net income	\$61,671	\$442,764
Other comprehensive income, net of tax:		
Unrealized gain (loss) on investment securities	1,347	(281)
Total comprehensive income	\$63,018	\$442,483
Net income per share:		
Basic	\$0.03	\$0.19
Diluted	\$0.03	\$0.19
Weighted average number of shares outstanding:		
Basic	2,359,493	2,326,364
Diluted	2,382,072	2,332,234
Dividends per share:	\$1.25	\$0.25

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

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ESPEY MFG. & ELECTRONICS CORP.

Statements of Cash Flows (Unaudited)

Three Months Ended September 30, 2018 and 2017

	September 30, 2018	September 30, 2017
Cash Flows from Operating Activities:		
Net income	\$61,671	\$442,764
Adjustments to reconcile net income to net cash used in operating activities:		
Stock-based compensation	37,371	21,423
Depreciation	122,872	105,674
ESOP compensation expense	101,361	89,460
Deferred income tax expense (benefit)	45,763	(2,795)
Changes in assets and liabilities:		
Increase in trade receivable, net	(1,417,803)	(244,628)
(Increase) decrease in income taxes receivable	(127,222)	163,761
Increase in inventories, net	(2,354,298)	(726,219)
Decrease (increase) in prepaid expenses and other current assets	1,014,850	(48,774)
Increase in accounts payable	758,776	76,326
Increase in accrued salaries and wages	58,419	87,154
Increase (decrease) in vacation accrual	3,385	(35,854)
Decrease in ESOP payable	—	(11,250)
Increase (decrease) in other accrued expenses	54,054	(117,909)
Increase in payroll and other taxes withheld	15,131	2,656
Net cash used in operating activities	(1,625,670)	(198,211)
Cash Flows from Investing Activities:		
Additions to property, plant and equipment	(611,995)	(28,758)
Purchase of investment securities	(2,577,706)	(2,583,383)
Proceeds from sale/maturity of investment securities	6,654,073	723,118
Net cash provided by (used in) investing activities	3,464,372	(1,889,023)
Cash Flows from Financing Activities:		
Dividends on common stock	—	(581,580)
Proceeds from exercise of stock options	200,123	—
Net cash provided by (used in) financing activities	200,123	(581,580)
Increase (decrease) in cash and cash equivalents	2,038,825	(2,668,814)
Cash and cash equivalents, beginning of period	4,298,796	10,058,163
Cash and cash equivalents, end of period	\$6,337,621	\$7,389,349
Supplemental Schedule of Cash Flow Information:		
Income taxes paid	\$80,000	\$920,000

Supplemental Schedule of Non-cash Financing Activities:

Accrual of dividends	\$2,995,404	\$—
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The accompanying notes are an integral part of the financial statements.

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ESPEY MFG. & ELECTRONICS CORP.

Notes to Financial Statements (Unaudited)

Note 1. Basis of Presentation

In the opinion of management the accompanying unaudited financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the results for such periods. The results for any interim period are not necessarily indicative of the results to be expected for the full fiscal year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles have been condensed or omitted. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of assets and liabilities. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition, inventories, income taxes, and stock-based compensation. Management bases its estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. These financial statements should be read in conjunction with the Company's most recent audited financial statements included in its report on Form 10-K for the year ended June 30, 2018. Certain reclassifications may have been made to the prior year financial statements to conform to the current year presentation.

Note 2. Investment Securities

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

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The carrying amounts of financial instruments, including cash and cash equivalents, short term investment securities, accounts receivable, accounts payable and accrued expenses, approximated fair value as of September 30, 2018 and June 30, 2018 because of the immediate or short-term maturity of these financial instruments.

Investment securities at September 30, 2018 and June 30, 2018 consist of certificates of deposit and municipal bonds which are classified as available-for-sale securities and have been determined to be level 1 assets. The cost, gross unrealized gains, gross unrealized losses and fair value of available-for-sale securities by major security type at September 30, 2018 and June 30, 2018 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2018				
Certificates of deposit	\$4,966,000	\$ —	\$ —	\$4,966,000

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Municipal bonds	2,482,635	1,020	(4,363)	2,479,292
Total investment securities	\$7,448,635	\$ 1,020	\$ (4,363)	\$7,445,292
June 30, 2018				
Certificates of deposit	\$10,440,000	\$ —	\$ —	\$10,440,000
Municipal bonds	1,085,754	635	(5,683)	1,080,706
Total investment securities	\$11,525,754	\$ 635	\$ (5,683)	\$11,520,706

The portfolio is diversified and highly liquid and primarily consists of investment grade fixed income instruments. At September 30, 2018, the Company did not have any investments in individual securities that have been in a continuous loss position considered to be other than temporary.

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As of September 30, 2018 and June 30, 2018, the remaining contractual maturities of available-for-sale securities were as follows:

	Years to Maturity		
	Less than One Year	One to Five Years	Total
September 30, 2018			
Available-for-sale	\$5,169,381	\$2,275,911	\$7,445,292
June 30, 2018			
Available-for-sale	\$10,967,300	\$553,406	\$11,520,706

Note 3. Net Income per Share

Basic net income per share excludes dilution and is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the income of the Company. The computation of weighted-average common shares outstanding, assuming dilution, excluded options to purchase 25,400 and 150,700 shares of our common stock for the three months ended September 30, 2018 and 2017, respectively, as the effect of including them would be anti-dilutive. As unearned ESOP shares are released or committed-to-be-released the shares become outstanding for earnings-per-share computations.

Note 4. Stock Based Compensation

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

Total stock-based compensation expense recognized in the statements of comprehensive income for the three-month periods ended September 30, 2018 and 2017 was \$37,371 and \$21,423, respectively, before income taxes. The related total deferred tax benefits were approximately \$2,034 and \$1,893 for the same periods.

As of September 30, 2018, there was approximately \$94,405 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 expected to be approximately \$4,670.

The Company has one employee stock option plan under which options or stock awards may be granted, the 2017 Stock Option and Restricted Stock Plan (the "2017 Plan"). The Board of Directors may grant options to acquire shares of common stock to employees and non-employee directors of the Company at the fair market value of the common stock on the date of grant. The maximum aggregate number of shares of Common Stock subject to options or awards to non-employee directors is 133,000 and the maximum aggregate number of shares of Common Stock subject to options or awards granted to non-employee directors during any single fiscal year is the lesser of 13,300 and 33 1/3% of the total number of shares subject to options or awards granted in such fiscal year. The maximum number of shares subject to options or awards granted to any individual employee may not exceed 15,000 in a fiscal year. 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. Options covering 400,000 shares are authorized for issuance under the 2017 plan, of which 55,215 have been granted as of September 30, 2018. While no further grants of options may be made under the Company's 2007 Stock Option and Restricted Stock Plan, as of September 30, 2018, 162,150 options were outstanding under such plan of which 125,800 are vested and exercisable.

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

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The table below outlines the weighted average assumptions that the Company used to calculate the fair value of each option award for the three months ended September 30, 2018. There were no options awarded for the three months ended September 30, 2017.

	September 30, 2018
Dividend yield	3.89%
Company's expected volatility	25.89%
Risk-free interest rate	2.75%
Expected term	5.1 yrs
Weighted average fair value per share of options granted during the period	\$4.405

The Company declares regular dividends quarterly and declared a first quarter regular cash dividend of \$0.25 per share and a special cash dividend of \$1.00 per share for the three months ended September 30, 2018. The company declared and paid a cash dividend of \$0.25 per share for the three months ended September 30, 2017. 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 three months ended September 30, 2018:

	Employee Stock Options Plan			
	Number of Shares Subject To Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at July 1, 2018	222,854	\$ 24.29	6.26	
Granted	500	\$ 25.70	9.77	
Exercised				