TAYLOR DEVICES INC
Form 10KSB
August 28, 2007

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
F O R M 10-KSB

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended May 31, 2007

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-3498

TAYLOR DEVICES, INC.
(Name of small business issuer as specified in its charter)

| New York | 16-0797789 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 90 Taylor Drive, P.O. Box 748, N. Tonawanda, New York | 14120-0748 |
| (Address of principal executive offices) | (Zip Code) |

Issuer's telephone number (716) 694-0800
Securities registered under Section 12(b) of the Exchange Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| None | None |

Securities registered under Section 12(g) of the Exchange Act:

Common Stock ($.025 par value)
(Title of class)

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the past twelve 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 _____

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B contained in this form, and no disclosure will 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-KSB or any amendments to Form 10-KSB [X].

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes _____ No X

Issuer's revenues for its most recent fiscal year are $16,501,400.

The aggregate market value of the Common Stock held by non-affiliates (as affiliates are defined in Rule 12b-2 of the Exchange Act) of the issuer, computed by reference to the average of the bid and asked price on August 17, 2007 was $13,711,011. In addition to shares held by affiliates, this calculation also excludes shares of the issuer's common stock that are held by Schedule 13D filers.

The number of shares outstanding of each of the registrant's classes of Common Stock, as of the latest practicable date.

| Class | Outstanding at August 17, 2007 |
|---|---|

| | |
|---|---|
| Common Stock, $.025 par value | 3,145,905 |

TAYLOR DEVICES, INC.

DOCUMENTS INCORPORATED BY REFERENCE

| Documents | Form 10-KSB Reference |
|---|---|
| Proxy Statement | Part III, Items 9-12 |

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## PART I

### ITEM 1. DESCRIPTION OF BUSINESS

The Company was incorporated in the State of New York on July 22, 1955 and is engaged in the design, development, manufacture and marketing of shock absorption, rate control, and energy storage devices for use in various types of machinery, equipment and structures. In addition to manufacturing and selling existing product lines, the Company continues to develop new and advanced technology products.

**Principal Products**

The Company manufactures and sells a single group of very similar products that have many different applications for customers. These similar products are included in one of six categories; namely, Seismic Dampers, Fluidicshoks®, Crane and Industrial Buffers, Self-Adjusting Shock Absorbers, Liquid Die Springs, and Vibration Dampers. Management does not track or otherwise account for sales broken down by these categories. The following is a summary of the capabilities and applications for these products.

Seismic Dampers are designed to ameliorate the effects of earthquake tremors on structures, and represent a substantial part of the business of the Company. Fluidicshoks® are small, extremely compact shock absorbers with up to 19,200 inch-pound capacities, produced in 15 standard sizes for primary use in the defense, aerospace and commercial industry. Crane and industrial buffers are larger versions of the Fluidicshoks® with up to 60,000,000 inch-pound capacities, produced in more than 60 standard sizes for industrial application on cranes, ships, container ships, railroad cars, truck docks, ladle and ingot cars, ore trolleys and car stops. Self-adjusting shock absorbers, which include versions of Fluidicshoks® and crane and industrial buffers, automatically adjust to different impact conditions, and are designed for high cycle application primarily in heavy industry. Liquid die springs are used as component parts of machinery and equipment used in the manufacture of tools and dies. Vibration dampers are used primarily by the aerospace and defense industries to control the response of electronics and optical systems subjected to air, ship, or spacecraft vibration.

**Distribution**

The Company utilizes the services of more than 50 sales representatives and distributors in the United States and Canada. Specialized technical sales in aerospace and custom marketing activities are serviced by three sales agents, under the direction and with the assistance of Douglas P. Taylor, the Company's President. Sales representatives typically have non exclusive, yearly agreements with the Company, which, in most instances, provide for payment of commissions on sales at 10% of the product's net aggregate selling price. Distributors also have non exclusive, yearly agreements with the Company to purchase the Company's products for resale purposes.

**Competition**

The Company faces competition on mature aerospace and defense programs which may use more conventional products manufactured under less stringent government specifications. Two foreign companies are the Company's competitors in the production of crane buffers.

The Company's principal competitors for the manufacture of products in the aerospace and commercial aerospace industries field are Cleveland Pneumatic Tool Company in Cleveland, Ohio, and Menasco Manufacturing Company in Burbank, California. While the Company is competitive with these companies in the areas of pricing, warranty and product performance, due to limited financing and manufacturing facilities, the Company cannot compete in the area of volume production.

The Company competes directly against two other firms supplying seismic damping devices, as well as numerous other firms which supply alternative seismic protection technologies.

**Raw Materials and Supplies**

The principal raw materials and supplies used by the Company in the manufacture of its products are provided by numerous U.S. suppliers. The loss of any one of these would not materially affect the Company's operations.

**Patents, Trademarks and Licenses**

Under a License Agreement ("License Agreement") dated November 1, 1959, between the Company and Tayco Developments, Inc. ("Developments"), an affiliate of the Company, the Company was granted preferential rights to market, in the United States and Canada, all

existing and future inventions and patents developed by Developments. The term of this License Agreement is the life of the last-to-expire patent on which the Company is paying royalties, which is the year 2021. During the life of each patent, the Company records a royalty payable to Developments, equal to five percent of sales value of patented items sold and shipped. The Company incurred royalty charges from Developments of $92,000 and $97,000 in the years ended May 31, 2007 and 2006, respectively. Under the License Agreement, payments of royalties are required to be made quarterly.

The License Agreement also provides for Developments to pay the Company 10% of the gross royalties received from third parties who are permitted to make, use and sell machinery and equipment under patents not subject to the License Agreement, as well as on apparatus and equipment subject to the License Agreement but modified by the Company, with rights to such modification having been assigned to Developments. No royalties were owed to the Company in the years ended May 31, 2007 and 2006. Royalties, if any, are paid quarterly.

Although the Company and Developments share common management and a close business relationship, as separate corporations responsible to their own shareholders, interests may diverge regarding development and licensing of future inventions and patents. In that case, Developments would be permitted to license future inventions and patents to parties other than the Company, rendering the Company's option on future inventions and patents under its License Agreement only minimally beneficial.

**Terms of Sale**

The Company does not carry significant inventory for rapid delivery to customers, and goods are not normally sold with return rights such as are available for consignment sales. The Company has no inventory out on consignment and no consignment sales for the years ended May 31, 2007 and 2006. No extended payment terms are offered. During the year ended May 31, 2007, delivery time after receipt of orders averaged 12 to 14 weeks for the Company's standard products. Due to the volatility of construction and aerospace/defense programs, progress payments are usually required for larger projects utilizing custom designed components of the Company.

**Dependence Upon Customers\Government Contracts**

The Company is not dependent on any one or a few major customers. Sales to two customers approximated 24% (15% and 9%, respectively) of net sales for 2007.

Contracts between the Company and the federal government or its independent contractors are subject to termination at the election of the federal government. Contracts are generally entered into on a fixed price basis. From time to time, the Company has also entered into a "cost plus" defense contract. If the federal government should limit defense spending, these contracts could be reduced or terminated, which would not have a materially adverse effect on the Company.

**Research and Development**

The Company does not normally engage in any major product research and development activities in connection with the design of its products, except when funded by aerospace customers or the federal government. See Item 1. Description of Business, "Patents, Trademarks and Licenses". The Company, however, engages in research testing of its products. For the fiscal years ended May 31, 2007 and 2006, the Company expended $162,000 and $129,000, respectively, on manufacturing research through Developments. For the years ended May 31, 2007 and 2006, defense sponsored research and development totaled $69,000 and $63,000, respectively.

**Government Regulation**

Compliance with federal, state and local laws and regulations which have been enacted or adopted regulating the discharge of materials into the environment has had no material effect on the Company, and the Company believes that it is in substantial compliance with such provisions.

The Company is subject to the Occupational Safety and Health Act ("OSHA") and the rules and regulations promulgated thereunder, which establish strict standards for the protection of employees, and impose fines for violations of such standards. The Company believes that it is in substantial compliance with OSHA provisions and does not anticipate any material corrective expenditures in the near future. The Company is currently incurring only moderate costs with respect to disposal of hazardous waste and compliance with OSHA regulations.

The Company is also subject to regulations relating to production of products for the federal government. These regulations allow for frequent governmental audits of the Company's operations and fairly extensive testing of Company products. The Company believes that it is in substantial compliance with these regulations and does not anticipate corrective expenditures in the future.

**Employees**

Exclusive of Company sales representatives and distributors, as of May 31, 2007, the Company had 92 employees, including three executive officers, and three part time employees. The Company has good relations with its employees.

**ITEM 2. DESCRIPTION OF PROPERTY**

The Company's production facilities occupy approximately six acres on Tonawanda Island in North Tonawanda, New York and are comprised of four interconnected buildings and one adjacent building. The production facilities consist of a small parts plant (approximately 4,400 square feet), a large parts plant (approximately 13,500 square feet), and include a facility of approximately 7,000 square feet constructed in 1995 (see below), a test facility, storage area, pump area and the Company's general offices. The adjacent building is a 17,000 square foot seismic assembly test facility. These facilities total more than 45,000 square feet. The Company has two separate remote test facilities used for shock testing. One facility is 800 square feet, and a newer, state-of-the-art test facility is 1,225 square feet. The small parts plant consists of a complete small machine shop and tool room that produces all of the Company's product items which are less than two inches in diameter. The large parts plant consists of a complete large machine shop and tool room. Both plants contain custom-built machinery for boring, deep-hole drilling and turning of parts.

In November 1994, as part of certain tax-exempt bond financing arrangements, the Company and the Niagara County Industrial Development Agency ("NCIDA") entered into a 15 year Series Lease by NCIDA to the Company of approximately 7,000 square feet of manufacturing space adjacent to the Company's existing large machine shop. The expansion partially accommodated the Company's increased need for additional manufacturing space for its seismic damper devices.

Rental payments, equivalent to payments of principal and interest due, are made quarterly by the Company over the term of the Lease, and are sufficient to amortize the $1,250,000 tax-exempt industrial development revenue Series A Bonds (the "Bond") issued by the NCIDA. The payments reimburse HSBC Bank, N.A. ("HSBC"), as issuer of the five year direct-pay irrevocable letter of credit, which is drawn upon by Deutsche Bank Trust Company Americas, as Trustee, for the benefit of the bondholders. The letter of credit was renewed by HSBC in November, 2004 for another five-year period. The Bond bears interest at the HSBC Adjustable Rate Service ("HSBC ARS") rate, plus an incremental amount designated by HSBC Securities, Inc. (the "Remarketing Agent"). The HSBC ARS rate reflects the current bid-side yield of the highest rated short-term, federally tax exempt obligations currently being traded, announced weekly by the Remarketing Agent, not to exceed 15% per annum, and is the minimum rate of interest necessary to enable the Remarketing Agent to remarket the Bond at par. Annual principal payments by the Company in June of each year range from $25,000 to $150,000, including a final principal payment of $45,000 upon maturity of the Bond on June 1, 2009. The Bond may be redeemed in whole, or in part, on any quarterly interest payment date, without penalty or premium. The principal amount outstanding on the Bond as of May 31, 2007 is $115,000.

Rental payments are secured by the liens of the Master Indenture between the NCIDA and the Trustee, the Series Supplemental Indenture between the NCIDA and the Trustee, and the Series Mortgage from the NCIDA, the Company, and Tayco Realty Corporation, an affiliate of the Company ("Tayco Realty"), to HSBC, as well as by other collateral security arrangements. When the Bond matures on June 1, 2009, the Company must purchase the Facility from the NCIDA for $1.00.

A renewal note dated June 1, 1998 due June 1, 2008 in the face amount of $174,778 is held by HSBC and is secured by property located at 90 Taylor Drive, North Tonawanda, New York. The principal balance at May 31, 2007 is $21,667.

A mortgage note dated January 1998, due February, 2013 in the face amount of $400,000 is also held by HSBC on property located at 90 Taylor Drive, North Tonawanda, New York, with an interest rate equal to the bank's prime interest rate plus 1%. A monthly payment of $2,222 is due on the first of each month. The principal balance at May 31, 2007 is $153,334. All payments on the above obligations are current.

Additional information regarding the Company's long-term debt is contained in Note 9 to the Consolidated Financial Statements filed with this report.

Except for the premises leased from the NCIDA, the Company leases portions of both the building and the property on which it is located from Tayco Realty. Pursuant to the Lease Agreement between the Company and Tayco Realty, rental payments from June 1, 2006 to May 31, 2007 totaled $159,600. The Lease Agreement, which contains standard terms and conditions, was renewed on November 1, 2005 for a term of ten years. Annual rentals are renegotiated by management of the two companies. The total rent paid by the Company is determined by a base rate, subject to adjustment for increases in taxes, maintenance costs and for utilization of additional space by the Company. The Company also pays for certain expenses incurred for the operation of the facilities. In addition, the Company leases a separate warehouse for storage from an unrelated third party, consisting of approximately 3,600 square feet at $825 per month. The warehouse is located approximately one-quarter mile from the above-referenced production facilities and office space. The total rental expense incurred by the Company for this facility in fiscal 2007 was $10,000. The Company also leases a separate facility for painting, packaging and shipping from an unrelated third party, consisting of approximately 10,000 square feet at $4,000 per month. The facility is located approximately four miles from the above-referenced production facilities and office space. The total rental expense incurred by the Company for this facility in fiscal 2007 was $28,000.

The Company believes it is carrying adequate insurance coverage on its facilities and their contents.

The following tables provide information regarding the properties discussed in this Item 2. Description of Property.

**TAYLOR DEVICES, INC. AND SUBSIDIARY**
**DISCLOSURE FOR REG. 228.102(c) FOR FILING 10-KSB**
**05/31/07**

**Reg. 228.102(c)-Real Estate**

| Property Location / Description<br>90 & 100 Taylor Drive<br>N. Tonawanda, NY 14120<br>(see below) | Cost | Book Accumulated Depreciation 5/31/2007 | Net Book Value 5/31/2007 | Percentage of Total Assets |
|---|---|---|---|---|
| Land | $ 141,483 | $ - | $ 141,483 | |
| Buildings | 1,154,353 | 769,778 | 384,575 | |
| Improvements | 2,668,263 | 916,240 | 1,752,023 | |
| Total | $ 3,964,099 | $ 1,686,018 | $ 2,278,081 | 13.7% |
| 90 Taylor Drive | | | | |
| Land | $ 107,363 | $ - | $ 107,363 | |
| Building | 428,506 | 428,506 | - | |
| Building Improvements-Realty | 297,665 | 69,720 | 227,945 | |
| Building Improvements-Devices | 2,370,598 | 846,520 | 1,524,078 | |
| Total | $ 3,204,132 | $ 1,344,746 | $ 1,859,386 | 11.2% |
| 100 Taylor Drive | | | | |
| Land | $ 34,120 | $ - | $ 34,120 | |
| Building | 725,847 | 341,272 | 384,575 | |
| Total | $ 759,967 | $ 341,272 | $ 418,695 | 2.5% |

Taylor Devices, Inc. & Subsidiary
Total Assets as of May 31, 2007 $ 16,652,390

**Reg. 228.102(c)(3)**

Pursuant to the Lease Agreement dated July 1, 2000 between the Company and Developments, the Company, which leases the parcel from Tayco Realty, sub-leases approximately 800 square feet of office and research and development space located at 100 Taylor Drive, North Tonawanda, to Developments at a base annual rental of $12,000. The rate of any rental increase may not exceed 10% annually and may be waived by both parties in writing. The sublease automatically renews on each anniversary of its commencement date, unless either party gives three months' written notice to the other of termination. The sublease provides that on April 1 of each year, management of both companies will review the agreement to determine possible increases for expenses due to increased taxes, maintenance costs, or for additional space utilized by Developments. In fiscal 2007, the Company received total rental payments of $12,000 from Developments.

**Reg.228.102(c)(7)(vi)(A-D)**

| Property Location / Description<br>90 & 100 Taylor Drive<br>N. Tonawanda, NY 14120<br>(see below) | Federal Tax Depreciation Methods | Federal Tax Life Claim | Federal Tax Cost | Federal Tax Accumulated Depreciation | Net Tax Basis 5/31/2007 |
|---|---|---|---|---|---|
| Building | Straight Line, MACRS | 15-40 Yrs. | $ 1,154,353 | $ 790,904 | $ 363,449 |
| | Straight Line | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Building Improvements | ACRS, MACRS | 7-40 Yrs. | 2,668,263 | 959,880 | 1,708,383 |
| Total | | | $ 3,822,616 | $ 1,750,784 | $ 2,071,832 |
| 90 Taylor Drive | | | | | |
| Building | Straight Line, MACRS | 15-31.5 Yrs. | $ 428,506 | $ 428,506 | $ - |
| Building Improvements-Realty | Straight Line | 7-39 Yrs. | 297,665 | 77,419 | 220,246 |
| Building Improvements-Devices | Straight Line ACRS, MACRS | 15-40 Yrs. | 2,370,598 | 882,461 | 1,488,137 |
| Total | | | $ 3,096,769 | $ 1,388,386 | $ 1,708,383 |
| 100 Taylor Drive | | | | | |
| Building | Straight Line | 19-40 Yrs. | $ 725,847 | $ 362,398 | $ 363,449 |

**Reg. 228.102(c)(7)(vii)**

The Company recorded $42,000 expense during the year for real property taxes and payments in lieu of taxes. This represents a combined tax rate of $36.98 per $1,000 of assessed valuation including a 50% reduction in taxes for the property leased from the NCIDA. This reduction will cease upon payment in full of the Bond and the Company's purchase for $1.00 of the land leased from the NCIDA.

**ITEM 3. LEGAL PROCEEDINGS**

None except for routine litigation incidental to the business.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

## PART II

**ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS ISSUER PURCHASES OF EQUITY SECURITIES**

**Market Information**

The Company's Common Stock trades on the Small Cap Market tier of the National Association of Securities Dealers Automated Quotation ("NASDAQ") stock market under the symbol TAYD. The high and low market prices noted below for the quarters of fiscal year 2007 and fiscal year 2006 were obtained from NASDAQ.

| | Fiscal 2007 | | Fiscal 2006 | |
|---|---|---|---|---|
| | High | Low | High | Low |
| First Quarter | 7.110 | 5.270 | 3.750 | 2.630 |
| Second Quarter | 6.140 | 4.310 | 4.680 | 2.838 |
| Third Quarter | 6.640 | 5.050 | 6.200 | 3.080 |

| | | | | |
|---|---|---|---|---|
| Fourth Quarter | 5.940 | 4.780 | 8.250 | 5.000 |

**Holders**

As of August 17, 2007, the number of issued and outstanding shares of Common Stock was 3,145,905, and the approximate number of record holders of the Company's Common Stock was 849. Due to a substantial number of shares of the Company's Common Stock held in street name, the Company believes that the total number of beneficial owners of its Common Stock exceeds 2,000.

**Dividends**

No cash or stock dividends have been declared during the last two fiscal years. Except as described below, under the terms of the Company's credit arrangement with its major lender, the Company is prohibited from issuing cash dividends.

On October 5, 1998, the Company's Board of Directors adopted a shareholder rights plan designed to deter coercive or unfair takeover tactics and prevent an acquirer from gaining control of the Company without offering a fair price to shareholders. Under the plan, certain rights ("Rights") were distributed as a dividend on each share of Common Stock (one Right for each share of Common Stock) held as of the close of business on or after October 19, 1998. Each whole Right entitles the holder, under certain defined conditions, to buy one two-thousandths (1/2000) of a newly issued share of the Company's Series A Junior Participating Preferred Stock ("Series A Preferred Stock") at an exercise price of $5.00. Rights attach to and trade with the shares of Common Stock, without being evidenced by a separate certificate. No separate Rights certificates will be issued unless and until the Rights detach from Common Stock and become exercisable for shares of the Series A Preferred Stock.

Such an event will occur if (1) a person or group acquires beneficial ownership of 30% or more of the Company's Common Stock (except through a tender or exchange offer for all shares which the Board determines is fair and in the best interests of the Company and its shareholders); or (2) a person or group commences a tender or exchange offer which will result in the person or group beneficially owning 24% or more of the Common Stock; or (3) the Board determines that a person or group holding at least 24% of the Common Stock intends to cause or pressure the Company into taking actions adverse to its or its shareholders' interests, or that the person or group is causing or is likely to cause a material adverse impact on the business or prospects of the Company. The Rights expire on October 5, 2008.

**Equity Compensation Plan Information**

The following table sets forth information regarding equity compensation plans of the Company as of May 31, 2007.

**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 plans (excluding securities reflected in column *(a)*) *(c)* |
|---|---|---|---|
| Equity compensation plans approved by security holders | | | |
| 1998 Stock Option Plan | 10,000 | $4.50 | - |
| 2001 Stock Option Plan | 25,000 | $4.20 | - |
| 2005 Stock Option Plan | 52,500 | $5.81 | 87,500 |
| Equity compensation plans not approved by security holders | | | |
| 2004 Employee Stock Purchase Plan (1) | - | - | 246,512 |

| | | |
|---|---|---|
| Total | 87,500 | 334,012 |

(1) The Company's 2004 Employee Stock Purchase Plan (the "Employee Plan") permits eligible employees to purchase shares of the Company's common stock at fair market value through payroll deductions and without brokers' fees. Such purchases are without any contribution on the part of the Company. As permitted by its terms, the Employee Plan had been suspended by the Board of Directors from August 10, 2004 until August 4, 2005. As of May 31, 2007, 246,512 shares were available for issuance.

**ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION**

**Cautionary Statement**

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Information in this Item 6, "Management's Discussion and Analysis or Plan of Operation," and elsewhere in this 10-KSB that does not consist of historical facts are "forward-looking statements." Statements accompanied or qualified by, or containing, words such as "may," "will," "should," "believes," "expects," "intends," "plans," "projects," "estimates," "predicts," "potential," "outlook," "forecast," "anticipates," "presume," and "assume" constitute forward-looking statements and, as such, are not a guarantee of future performance. The statements involve factors, risks and uncertainties, the impact or occurrence of which can cause actual results to differ materially from the expected results described in such statements. Risks and uncertainties can include, among others, fluctuations in general business cycles and changing economic conditions; changing product demand and industry capacity; increased competition and pricing pressures; advances in technology that can reduce the demand for the Company's products, as well as other factors, many or all of which may be beyond the Company's control. Consequently, investors should not place undue reliance on forward-looking statements as predictive of future results. The Company disclaims any obligation to release publicly any updates or revisions to the forward-looking statements herein to reflect any change in the Company's expectations with regard thereto, or any changes in events, conditions or circumstances on which any such statement is based.

**Results of Operations**

A summary of the period to period changes in the principal items included in the consolidated statements of income is shown below:

**Summary comparison of the years ended May 31, 2007 and 2006**

| | Increase / (Decrease) |
|---|---|
| Sales, net | $ 1,751,000 |
| Cost of goods sold | $ 308,000 |
| Selling, general and administrative expenses | $ 1,016,000 |
| Other income / (expense) | $ 139,000 |
| Income before provision for income taxes, equity in net income of affiliate and minority stockholder's interest | $ 287,000 |
| Provision for income taxes | $ 173,000 |
| Income before equity in net income of affiliate and minority stockholder's interest | $ 115,000 |
| Equity in net income (loss) of affiliate | $ 23,000 |
| Net income | $ 133,000 |

Sales under certain fixed-price contracts requiring substantial performance over several periods prior to commencement of deliveries are accounted for under the percentage-of-completion method of accounting whereby revenues are recognized based on estimates of completion prepared on a ratio of cost to total estimated cost basis. Costs include all material and direct and indirect charges related to specific contracts.

Adjustments to cost estimates are made periodically and any losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. However, any profits expected on contracts in progress are recognized over the life of the contract.

For financial statement presentation purposes, the Company nets progress billings against the total costs incurred on uncompleted contracts. The asset, "costs and estimated earnings in excess of billings," represents revenues recognized in excess of amounts billed. The liability, "billings in excess of costs and estimated earnings," represents billings in excess of revenues recognized.

**For the year ended May 31, 2007** (All figures being discussed are for the year ended May 31, 2007 as compared to the year ended May 31, 2006.)

| | Year ended | | Change | |
|---|---|---|---|---|
| | **May 31, 2007** | **May 31, 2006** | **Increase / (Decrease)** | **Percent Change** |
| Net Revenue | $16,501,000 | $14,751,000 | $ 1,750,000 | *12%* |
| Cost of sales | 10,746,000 | 10,438,000 | 308,000 | *3%* |
| Gross profit | $ 5,755,000 | $ 4,313,000 | $ 1,442,000 | *33%* |
| *…as a percentage of net revenues* | *35%* | *29%* | | |

The Company's consolidated results of operations showed a 12% increase in net revenues and an increase in net income of 27%. Gross profit increased by 33%. Revenues recorded in the current period for long-term construction projects decreased slightly over the level recorded in the prior year. Revenues recorded for all other product sales increased by 50% over last year. This significant increase is primarily due to customers in aerospace and defense related businesses. The gross profit as a percentage of net revenues for the current and prior year periods was 35% and 29%, respectively. Management is optimistic that the level of construction activity of structures requiring seismic protection as well as the demand for our products in aerospace and defense applications, will remain strong through the fiscal year ending May 31, 2008.

The Company's revenues and net income fluctuate from period to period. The increases in the current period, compared to the prior period, are not necessarily representative of future results.

**Selling, General and Administrative Expenses**

| | Year ended | | Change | |
|---|---|---|---|---|
| | **May 31, 2007** | **May 31, 2006** | **Increase / (Decrease)** | **Percent Change** |
| Outside Commissions | $1,322,000 | $ 875,000 | $ 447,000 | *51%* |
| Other SG&A | 3,090,000 | 2,520,000 | 570,000 | *23%* |
| Total SG&A | $4,412,000 | $3,395,000 | $1,017,000 | *30%* |
| *…as a percentage of net revenues* | *27%* | *23%* | | |

Selling, general and administrative expenses increased by 30% from the prior year. Outside commission expense increased by 51% over last year's level. Outside commission expense was higher in this period due to higher commission rates on a few large, long-term construction projects in production, in addition to a higher volume of sales subject to commission. Other selling, general and administrative expenses increased by 23% from last year. This increase is primarily related to personnel costs, including the cost of stock options issued during the year, inside sales commissions, management incentive compensation and general wage increases.

The above factors resulted in operating income of $1,343,000 for the year ended May 31, 2007, up 46% from the $918,000 in the prior year.

Interest expense of $307,000 is 87% more than in the prior year. The average level of use of the Company's operating line of credit increased from $1.3 million last year to $2.9 million this year. The interest rate on the operating line of credit increased 0.25 percentage points since May 31, 2006. The line of credit is used primarily to fund the production of larger projects that do not allow for advance payments or progress payments.

**Stock Options**

The Company has a stock option plan which provides for the granting of nonqualified or incentive stock options to officers, key employees and non-employee directors. Options granted under the plan are exercisable over a ten year term. Options not exercised by the end of the term expire.

On June 1, 2006, the Company adopted the stock option expensing rules of Statement of Financial Accounting Standards (SFAS) No. 123R, "Share Based Payment," using the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." The Company utilized the modified prospective approach of adoption under SFAS No. 123R which resulted in the recognition of $119,000 of compensation cost for the year ended May 31, 2007. Results for prior periods have not been restated.

The fair value of each stock option grant has been determined using the Black-Scholes model. The model considers assumptions related to exercise price, expected volatility, risk-free interest rate, and the weighted average expected term of the stock option grants. The Company used a weighted average expected term. Expected volatility assumptions utilized in the model were based on volatility of the Company's stock price for the thirty month period immediately preceding the granting of the options. The Company issued stock options in August 2006 and April 2007. The risk-free interest rate is derived from the U.S. treasury yield. The following assumptions were used in the Black-Scholes model in estimating the fair market value of the Company's stock option grants:

| | August 2006 | April 2007 |
|---|---|---|
| Risk-free interest rate: | 3% | 3.375% |
| Expected life of the options: | 2.5 years | 2.5 years |
| Expected share price volatility: | 92% | 87% |
| Expected dividends: | zero | zero |
| These assumptions resulted in estimated fair-market value per stock option: | $3.41 | $2.95 |

The ultimate value of the options will depend on the future price of the Company's common stock, which cannot be forecast with reasonable accuracy.

A summary of changes in the stock options outstanding during the year ended May 31, 2007 is presented below:

| | Number of Options | Weighted-Average Exercise Price |
|---|---|---|
| Options outstanding and exercisable at May 31, 2006: | 85,250 | $ 4.054 |
| Options granted: | 38,250 | $ 5.781 |
| Options exercised: | - | - |
| Options expired: | 36,000 | $ 3.108 |
| Options outstanding and exercisable at May 31, 2007: | 87,500 | $ 5.200 |

The Company previously applied APB Opinion 25 "Accounting for Stock Issued to Employees" and related interpretations in accounting for its stock option plans. Since the option price was the fair market value per share on the date the option was granted, no compensation cost had been recognized for its stock option plans in reporting periods prior to the year ending May 31, 2007.

**Capital Resources, Line of Credit and Long-Term Debt**

The Company's primary liquidity is dependent upon its working capital needs. These are primarily inventory, accounts receivable, costs and estimated earnings in excess of billings, accounts payable, accrued commissions, billings in excess of costs and estimated earnings, and debt service. The Company's primary sources of liquidity have been operations and bank financing.

Capital expenditures for the year ended May 31, 2007 were $252,000 compared to $253,000 in the prior year. The Company has commitments to pay $143,000 for production machinery in the fiscal year ending May 31, 2008.

The Company has a $5,000,000 line of credit with a bank. There is a $1,628,000 principal balance outstanding as of May 31, 2007, which is down from the $3,011,000 balance outstanding as of May 31, 2006. The outstanding balance on the line of credit will fluctuate as the Company's various long-term projects progress. The Company is in compliance with restrictive covenants under the line of credit and other financing arrangements, including the NCIDA Bond financing. In these covenants, the Company agrees to:

- Maintain a minimum working capital position of $2,000,000 at all times;
- limit annual capital expenditures to $650,000;
- maintain a minimum debt service coverage ratio of no less than 1:1; and
- advise the bank of any litigation where the claim amount is $100,000 or greater.

Additional information regarding the Company's long-term debt appears in Part I, item 2 of this Report.

Principal maturities of long-term debt for the subsequent five years are as follows: 2008 - $238,000; 2009 - $138,000; 2010 - $72,000; 2011 - $27,000; and 2012 - $27,000.

**Inventory and Maintenance Inventory**

| | **May 31, 2007** | | **May 31, 2006** | | **Increase** | |
|---|---|---|---|---|---|---|
| Raw Materials | $ 425,000 | | $ 413,000 | | $ 12,000 | *3%* |
| Work in process | 4,221,000 | | 3,404,000 | | 817,000 | *24%* |
| Finished goods | 447,000 | | 400,000 | | 47,000 | *12%* |
| Inventory | 5,093,000 | *87%* | 4,217,000 | *89%* | 876,000 | *21%* |

| | | | | |
|---|---|---|---|---|
| Maintenance and other inventory | 754,000 | *13%* | 543,000 | *11%* | 211,000 | *39%* |
| Total | $ 5,847,000 | *100%* | $ 4,760,000 | *100%* | $ 1,087,000 | *23%* |
| Inventory turnover | 2.0 | | 2.0 | | | |

Inventory, at $5,093,000 as of May 31, 2007, is 21% higher than the prior year-end. Of this, approximately 83% is work in process, 9% is finished goods, and 8% is raw materials.

Maintenance and other inventory represent stock that is estimated to have a product life cycle in excess of twelve months. This stock represents certain items that the Company is required to maintain for service of products sold and items that are generally subject to spontaneous ordering. This inventory is particularly sensitive to technical obsolescence in the near term due to its use in industries characterized by the continuous introduction of new product lines, rapid technological advances and product obsolescence. Management of the Company has recorded an allowance for potential inventory obsolescence. The provision for potential inventory obsolescence was $165,000 for the year ended May 31, 2007 and $140,000 for the same period last year. The Company continues to rework slow-moving inventory, where applicable, to convert it to product to be used on customer orders. There was an insignificant amount of slow-moving inventory used during the year ended May 31, 2007. The Company disposed of approximately $184,000 and $310,000 of obsolete inventory during the years ended May 31, 2007 and 2006, respectively.

**Accounts Receivable, Costs and Estimated Earnings in Excess of Billings, and Billings in Excess of Costs and Estimated Earnings**

| | **May 31, 2007** | **May 31, 2006** | **Increase /(Decrease)** | |
|---|---|---|---|---|
| Accounts receivable | $ 3,894,000 | $ 2,423,000 | $ 1,471,000 | *61%* |
| Costs and estimated earnings in excess of billings | 1,991,000 | 5,062,000 | (3,071,000) | *-61%* |
| Less: Billings in excess of costs and estimated earnings | 18,000 | 95,000 | (77,000) | *-81%* |
| Net | $ 5,867,000 | $ 7,390,000 | $ (1,523,000) | *-21%* |

The Company combines the totals of accounts receivable, the asset "costs and estimated earnings in excess of billings", and the liability, "billings in excess of costs and estimated earnings", to determine how much cash the Company will eventually realize from revenue recorded to date. As the accounts receivable figure rises in relation to the other two figures, the Company can anticipate increased cash receipts within the ensuing 30-60 days.

Accounts receivable of $3,894,000 as of May 31, 2007 includes approximately $557,000 of amounts retained by customers on long-term construction projects. The Company expects to collect all of these amounts, including the retainage, during the next twelve months.

As noted above, the current asset, "costs and estimated earnings in excess of billings," represents revenues recognized in excess of amounts billed. Whenever possible, the Company negotiates a provision in sales contracts to allow the Company to bill, and collect from the customer, payments in advance of shipments. Unfortunately, provisions such as this are often not possible. The $1,991,000 balance in this account at May 31, 2007 is a 61% decrease from the prior year-end. This significant decrease from last year-end is a reflection of 1.) the decrease in the number of projects in progress at the two balance sheet dates (18 at May 31, 2007 compared to 25 at May 31, 2006) and 2.) the amount of progress billings permitted per the terms of the various sales agreements for the projects (42% of the aggregate order value of the projects in progress at May 31, 2007 has been invoiced to the customers compared to 19% at May 31, 2006). In the aggregate, the projects in progress at May 31, 2007 are 70% complete at that date while the projects in progress at May 31, 2006 were 53% complete at that date. The average total sales value of long-term construction projects in process at the end of this year is 29% lower than the end of last year. Generally, if progress billings are permitted under the terms of a project sales agreement, then the more complete the project is, the more progress billings will be permitted. The Company expects to bill the entire amount during the next twelve months.

As of May 31, 2007, there are sales orders for seven projects that are not yet in progress. These projects average almost $450,000 each in value upon completion. This compares to one such project as of the prior year end with a value of slightly more that half of the average value of these projects at May 31, 2007.

The year-end balances in this account are comprised of the following components:

| | **May 31, 2007** | **May 31, 2006** |
|---|---|---|
| Costs | $ 3,218,000 | $ 4,792,000 |
| Estimated earnings | 1,787,000 | 2,760,000 |
| Less: Billings to customers | 3,014,000 | 2,490,000 |

| | | |
|---|---|---|
| Costs and estimated earnings in excess of billings | $ 1,991,000 | $ 5,062,000 |
| Number of projects in progress | 17 | 23 |

As noted above, the current liability, "billings in excess of costs and estimated earnings", represents billings to customers in excess of revenues recognized. The $18,000 balance in this account at May 31, 2007 is a $77,000 decrease from the balance at the end of the prior year. The balance in this account fluctuates in the same manner and for the same reasons as the account "costs and estimated earnings in excess of billings", discussed above. Final delivery of product under these contracts is expected to occur during the next twelve months.

The year-end balances in this account are comprised of the following components:

| | **May 31, 2007** | **May 31, 2006** |
|---|---|---|
| Billings to customers | $ 72,000 | $ 254,000 |
| Less: Costs | 39,000 | 110,000 |
| Less: Estimated earnings | 15,000 | 49,000 |
| Billings in excess of costs and estimated earnings | $ 18,000 | $ 95,000 |
| Number of projects in progress | 1 | 2 |

Summary of factors affecting the year-end balances in the asset "costs and estimated earnings in excess of billings", and the liability, "billings in excess of costs and estimated earnings":

| | **2007** | **2006** |
|---|---|---|
| Number of projects in progress at year-end | 18 | 25 |
| Aggregate percent complete at year-end | 70% | 53% |
| Average total value of projects in progress at year-end | $408,000 | $578,000 |
| Percentage of total value invoiced to customer | 42% | 19% |

The Company's backlog of sales orders at May 31, 2007 is $12.5 million, up slightly from the backlog at the end of the prior year of $12.4 million. $2.3 million of the current backlog is on projects already in progress.

Accounts payable, at $994,000 as of May 31, 2007, is approximately $321,000 less than the prior year-end. This 24% decrease is primarily attributable to the advanced stage of completion of the projects in progress. The materials and sub-contracted services needed to complete them are mostly already purchased and paid-for.

Commission expense on applicable sales orders is recognized at the time revenue is recognized. The commission is paid following receipt of payment from the customers. Accrued commissions as of May 31, 2007 are $666,000. This is 32% lower than the $983,000 accrued at the prior year-end. This significant decrease is reasonable due to the decrease in the current asset, "costs and estimated earnings in excess of billings" by $3,071,000 with an increase in accounts receivable of only $1,471,000. These changes show that we billed the customers for long-term construction projects in progress at the end of the prior year, received payment for much of what we billed, then paid the commissions to the sales representatives prior to May 31, 2007. Commission expense related to long-term construction projects is recorded at the same time as revenue on the projects is recorded. This liability will not decrease until progress billings on the projects have been issued by the Company and are paid by our customers. The Company expects the current accrued amount to be paid during the next twelve months. Other current liabilities increased by $535,000 from the prior year-end, to $929,000. This is primarily due to an increase in customer advance deposits on non-project sales orders and long-term construction projects that are not yet in progress.

The Company paid $98,000 to Developments during the year ended May 31, 2007, reducing the principal balance on the note payable to $144,000.

Management believes that the Company's cash flows from operations and borrowing capacity under the bank line of credit will be sufficient to fund ongoing operations, capital improvements and share repurchases for the next twelve months.

**ITEM 7. FINANCIAL STATEMENTS**

For information concerning this Item, see the Company's balance sheet and related financial statements at Item 13.

**ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES**

There have been no disagreements between the Company and its accountants as to matters which require disclosure.

**ITEM 8A. CONTROLS AND PROCEDURES**

(a) *Evaluation of disclosure controls and procedures*.

The Company's principal executive officer and principal financial officer have evaluated the Company's disclosure controls and procedures as of May 31, 2007 and have concluded that, as of the evaluation date, the disclosure controls and procedures were effective to ensure that material information relating to the Company was accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, to allow for timely decisions regarding required disclosure.

(b) *Changes in internal controls.*

There have been no changes in the Company's internal controls over financial reporting that occurred during the fiscal quarter ended May 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's control over financial reporting.

**ITEM 8B. OTHER INFORMATION**

None.

**PART III**

The information required by Items 9, 10, 11 and 12 of this part will be presented in the Company's Proxy Statement to be issued in connection with the Annual Meeting of Shareholders to be held on November 2, 2007, which information is hereby incorporated by reference into this Annual Report. The proxy materials, including the Proxy Statement and Annual Report to Shareholders, will be filed within 120 days after the Company's fiscal year end.

**ITEM 13. EXHIBITS**

DOCUMENTS FILED AS PART OF THIS REPORT:

Index to Financial Statements:

(i) Report of Independent Registered Public Accounting Firm

(ii) Consolidated Balance Sheets May 31, 2007 and 2006

(iii) Consolidated Statements of Income for the years ended May 31, 2007 and 2006

(iv) Consolidated Statements of Stockholders' Equity for the years ended May 31, 2007 and 2006

(v) Consolidated Statements of Cash Flows for the years ended May 31, 2007 and 2006

(vi) Notes to Consolidated Financial Statements May 31, 2007 and 2006

(a) EXHIBITS:

(3) Articles of incorporation and by-laws

(i) Restated Certificate of Incorporation incorporated by reference to Exhibit (3)(i) of Annual Report on Form 10-K, dated August 24, 1983.

(ii) Amendment to Certificate of Incorporation incorporated by reference to Exhibit (3)(iv) to Form 8 [Amendment to Application or Report], dated September 24, 1993.

(iii) Amendment to Certificate of Incorporation creating Series A Junior Participating Preferred Stock, $.05 par value, incorporated by reference to Exhibit (3)(i)(viii) to Quarterly Report on Form 10-QSB for the period ending November 30, 1998, dated January 12, 1999.
.

(iv) Certificate of Change incorporated by reference to Exhibit (3)(i) to Quarterly Report on Form 10-QSB for the period ending November 30, 2002.

(v) Proxy Review Guidelines incorporated by reference to Exhibit (3)(ii) to Quarterly Report on Form 10-QSB for the period ending February 28, 1998, dated April 10, 1998.

(vi) By-laws incorporated by reference to Exhibit (3)(i) to Quarterly Report on Form 10-QSB for the period ending February 28, 2004, dated April 14, 2004.

(4) Instruments defining rights of security holders, including indentures

(i) Mortgage to Marine Midland Bank dated May 28, 1993 incorporated by reference to Exhibit (10)(vii) to Annual Report on Form 10-KSB, dated September 10, 1993.

(ii) Master Indenture between Niagara County Industrial Development Agency and Bankers Trust Company, as Trustee, dated as of November 1, 1994 ($1,250,000 Niagara County Industrial Development Agency, 1994 Adjustable Rate Demand, Industrial Development Revenue Bonds, Series A [MMARS Second Program]), incorporated by reference to Exhibit (4)(iv) to Annual Report on Form 10-KSB, dated August 21, 1995.

(iii) Series Supplemental Indenture between Niagara County Industrial Development Agency and Bankers Trust Company, as Trustee, ($1,250,000 Niagara County Industrial Development Agency, 1994 Adjustable Rate Demand, Industrial Development Revenue Bonds, Series A [MMARS Second Program]), incorporated by reference to Exhibit (4)(v) to Annual Report on Form 10-KSB, dated August 21, 1995.

(iv) Series Mortgage from Niagara County Industrial Development Agency, Tayco Realty, Inc. and registrant to Marine Midland Bank, as Letter of Credit Bank, dated as of November 1, 1994, incorporated by reference to Exhibit (4)(vi) to Annual Report on Form 10-KSB, dated August 21, 1995.

(v) Mortgage from Niagara County Industrial Development Agency, Tayco Realty, Inc. and registrant to Marine Midland Bank, dated January 3, 1998, incorporated by reference to Exhibit (4)(v) to Annual Report on Form 10-KSB, dated August 25, 1998.

(vi) Rights Agreement by and between registrant and Regan & Associates, Inc, dated as of October 5, 1998 and letter to shareholders (including Summary of Rights), dated October 5, 1998, attached as Exhibits 4 and 20, respectively to Registration Statement on Form 8-A 12G, filed with the Securities and Exchange Commission on October 6, 1998.

(10) Material Contracts

(i) 1994 Taylor Devices, Inc. Stock Option Plan incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8, File No. 33-88152, as filed with the Securities and Exchange Commission on December 30, 1994.

(ii) 1998 Taylor Devices, Inc. Stock Option Plan attached as Exhibit 4.1 to Registration Statement on Form S-8, File No. 33-6905, filed with the Securities and Exchange Commission on December 24, 1998.

(iii) 2001 Taylor Devices, Inc. Stock Option Plan attached as Exhibit A to Definitive Proxy Statement, filed with the Securities and Exchange Commission on September 24, 2001.

(iv) 2005 Taylor Devices, Inc. Stock Option Plan attached as Appendix B to Definitive Proxy Statement, filed with the Securities and Exchange Commission on September 27, 2005.

(v) License Agreement between the registrant and Tayco Developments, Inc., dated November 1, 1959, incorporated by reference to Exhibit (10)(i) to Annual Report on Form 10-K, dated August 27, 1982.

(vi) Loan Agreements between the registrant and Marine Midland Bank, dated December 2, 1992, incorporated by reference to Exhibit (10)(viii) to Annual Report on Form 10-K, dated September 10, 1993.

(vii) Series Lease between Niagara County Industrial Development Agency and registrant, dated as of November 1, 1994 ($1,250,000 Niagara County Industrial Development Agency, 1994 Adjustable Rate Demand, Industrial Development Revenue Bonds, Series A [MMARS Second Program]), incorporated by reference to Exhibit (10)(ix) to the Annual Report on Form 10-KSB, dated August 21, 1995.

(viii) Lease Agreement between registrant and Tayco Realty Corporation, dated November 1, 1995, incorporated by reference to Exhibit (10)(ix) to Annual Report on Form 10-KSB, dated August 22, 1996.

(ix) Form of Indemnity Agreement between registrant and certain officers and directors, incorporated by reference to Exhibit (10)(i) to Quarterly Report on Form 10-QSB for the period ending February 28, 1997, dated April 11, 1997.

(x) Lease Agreement dated July 1, 2000 between the Registrant and Tayco Developments, Inc., incorporated by reference to Exhibit (10)(xii) to Annual Report on Form 10-KSB, dated August 25, 2000.

(xi) Employment Agreement dated as of December 1, 2000 between the Registrant and Douglas P. Taylor, incorporated by reference to Exhibit (10)(x) to Annual Report on Form 10-KSB, dated August 22, 2001.

(xii) Employment Agreement dated as of December 1, 2000 between the Registrant and Richard G. Hill, incorporated by reference to Exhibit (10)(xi) to Annual Report on Form 10-KSB, dated August 22, 2001.

(xiii) Indemnity Agreement between registrant and Mark V. McDonough, incorporated by reference to Exhibit (10)(i) to Quarterly Report on Form 10-QSB for the period ending August 31, 2004, dated October 15, 2004.

(xiv) The 2004 Taylor Devices, Inc. Employee Stock Purchase Plan, incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-8, File No. 333-114085, filed with the Securities and Exchange Commission on March 31, 2004.

(xv) Promissory Note between the Company and Tayco Developments, Inc., dated June 1, 2007, attached to this Annual Report on Form 10-KSB.

(xvi) Indemnity Agreement between registrant and Reginald B. Newman II, incorporated by reference to Exhibit (10)(i) to Quarterly Report on Form 10-QSB for the period ending November 30, 2006, dated November 11, 2006.

(xvii) Post-Effective Amendment No. 1 to Registration Statement on Form S-8, File No. 333-114085, for the 2004 Taylor Devices, Inc. Employee Stock Purchase Plan, filed with the Securities and Exchange Commission on August 24, 2006.

(xviii) Indemnity Agreement between registrant and John Burgess, incorporated by reference to Exhibit (10)(i) to Quarterly Report on Form 10-QSB for the period ending February 28, 2007, dated March 7, 2007.

(xix) First Amendment to Employment Agreement dated as of December 22, 2006 between the Registrant and Douglas P. Taylor, incorporated by reference to Exhibit 10(ii) to Quarterly Report on Form 10-QSB for the period ending February 28, 2007.

(xx) First Amendment to Employment Agreement dated as of December 22, 2006 between the Registrant and Richard G. Hill, incorporated by reference to Exhibit 10(iii) to Quarterly Report on Form 10-QSB for the period ending February 28, 2007.

(11) Statement regarding computation of per share earnings

REG. 228.601(A)(11) Statement regarding computation of per share earnings

Weighted average of common stock/equivalents outstanding - fiscal year ended May 31, 2007

| | |
|---|---|
| Weighted average common stock outstanding | 3,143,964 |
| Common shares issuable under stock option plans using treasury stock method | 8,226 |
| Weighted average common stock outstanding assuming dilution | 3,152,190 |

| | | |
|---|---|---|
| Net income fiscal year ended May 31, 2007 | (1) | $ 619,273 |
| Weighted average common stock | (2) | 3,143,964 |
| Basic income per common share | (1) divided by (2) | $ .20 |

| | | |
|---|---|---|
| Net income fiscal year ended May 31, 2007 | (3) | $ 619,273 |
| Weighted average common stock outstanding assuming dilution | (4) | 3,152,190 |

| | | |
|---|---|---|
| Diluted income per common share | (3) divided by (4) | $ .20 |

Weighted average of common stock/equivalents outstanding - fiscal year ended May 31, 2006

| | |
|---|---|
| Weighted average common stock outstanding | 3,112,747 |
| Common shares issuable under stock option plans using treasury stock method | 10,712 |
| Weighted average common stock outstanding assuming dilution | 3,123,459 |

| | | |
|---|---|---|
| Net income fiscal year ended May 31, 2006 | (1) | $ 485,793 |
| Weighted average common stock | (2) | 3,112,747 |
| Basic income per common share | (1) divided by (2) | $ .16 |

| | | |
|---|---|---|
| Net income fiscal year ended May 31, 2006 | (3) | $ 485,793 |
| Weighted average common stock outstanding assuming dilution | (4) | 3,123,459 |
| Diluted income per common share | (3) divided by (4) | $ .16 |

(14) Code of Ethics, incorporated by reference to Exhibit 14 to Annual Report on Form 10-KSB for the period ending May 31, 2004.

(20) Other documents or statements to security holders

(i) News from Taylor Devices, Inc. Shareholder Letter, Summer 2007.

(21) Subsidiaries of the registrant

Tayco Realty Corporation is a New York corporation organized on September 8, 1977, 58% owned by the Company and 42% owned by Tayco Developments, Inc.

(23) Report and Consent of Independent Certified Public Accountants

(31) Officer Certifications

(i) Certification of Chief Executive Officer pursuant to Section 302 of Sarbanes-Oxley Act.

(ii) Certification of Chief Financial Officer pursuant to Section 302 of Sarbanes-Oxley Act.

(32) Officer Certifications

(i) Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act.

(ii) Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act.

(b) REPORTS ON FORM 8-K:

None.

**ITEM 14: PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The Audit Committee of the Company approves all professional services, including tax related services, provided to the Company by Lumsden & McCormick, LLP. With regard to "Audit and Audit-Related" services, the Committee reviews the annual audit plan and approves the estimated audit budget in advance. The aggregate fees billed by Lumsden & McCormick, LLP for professional services to the Company were $72,500 and $76,200 for the fiscal years ended May 31, 2007 and 2006.

**Audit Fees**

The aggregate fees billed by Lumsden & McCormick, LLP for professional services rendered in connection with the audit of the Company's annual financial statements, the review of the Company's quarterly financial statements and services that are normally provided in connection with statutory and regulatory filings or engagements were $67,500 and $66,500 for the fiscal years ended May 31, 2007 and 2006.

**Audit-Related Fees**

The aggregate fees billed by Lumsden & McCormick, LLP for professional assurance and related services reasonably related to the performance of the audit of the Company's financial statements, but not included under Audit Fees, were zero and $3,900 for the fiscal years ended May 31, 2007 and 2006.

**Tax Fees**

The aggregate fees billed by Lumsden & McCormick, LLP for professional services for tax compliance, tax advice and tax planning were $5,000 and $5,800 for the fiscal years ended May 31, 2007 and 2006.

**All Other Fees**

None.

**Pre-approval Policies and Procedures**

The Audit Committee has adopted a policy that requires advance approval of all audit, audit-related, tax services, and other services performed by the independent auditor. The policy provides for pre-approval by the Audit Committee of specifically defined audit and non-audit services. Unless the specific service has been previously pre-approved with respect to that year, the Audit Committee must approve the permitted service before the independent auditor is engaged to perform it.

**SIGNATURES**

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TAYLOR DEVICES, INC.
(Registrant)

By: /s/Douglas P. Taylor
Douglas P. Taylor
President and Director
(Principal Executive Officer)
and

Date: August 17, 2007

By: /s/Mark V. McDonough
Mark V. McDonough
Chief Financial Officer

Date: August 17, 2007

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/Reginald B. Newman II
Reginald B. Newman II, Director
August 17, 2007

By: /s/Richard G. Hill
Richard G. Hill, Director
August 17, 2007

By: /s/John Burgess
John Burgess, Director
August 17, 2007

By: /s/Randall L. Clark
Randall L. Clark, Director
August 17, 2007

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To The Board of Directors of
Taylor Devices Inc.

Gentlemen:

We hereby consent to the incorporation by reference in this Annual Report on Form 10-KSB (Commission File Number 0-3498) of Taylor Devices Inc. of our report dated July 19, 2007 and any reference thereto in the Annual Report to Shareholders for the fiscal year ended May 31, 2007.

**LUMSDEN & McCORMICK, LLP**
Buffalo, New York
July 19, 2007

**TAYLOR DEVICES, INC. AND SUBSIDIARY**

**CONSOLIDATED FINANCIAL STATEMENTS**

**May 31, 2007**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders
Taylor Devices, Inc.

We have audited the accompanying consolidated balance sheets of Taylor Devices, Inc. and Subsidiary as of May 31, 2007 and 2006 and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. 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. 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 Taylor Devices, Inc. and Subsidiary as of May 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1 and 15 to the consolidated financial statements, effective June 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standard No. 123 (revised 2004), *Share-Based Payment*.

Lumsden & McCormick, LLP
Buffalo, New York
July 19, 2007

TAYLOR DEVICES, INC. AND SUBSIDIARY

**Consolidated Balance Sheets**

| May 31, | 2007 | 2006 |
|---|---|---|
| **Assets** | | |
| **Current assets:** | | |
| Cash and cash equivalents | $ 22,748 | $ 60,011 |
| Restricted funds held by Trustee (Note 9) | 29,978 | 25,756 |
| Accounts receivable, net (Note 2) | 3,893,793 | 2,423,428 |
| Inventory (Note 3) | 5,093,146 | 4,216,633 |
| Prepaid expenses | 254,980 | 172,460 |
| Prepaid income taxes | - | 224,698 |
| Costs and estimated earnings in excess of billings (Note 4) | 1,991,183 | 5,062,294 |
| Deferred income taxes (Note 11) | 669,400 | 631,015 |
| **Total current assets** | 11,955,228 | 12,816,295 |
| Maintenance and other inventory, net (Note 5) | 753,825 | 543,057 |
| Property and equipment, net (Note 6) | 3,349,810 | 3,419,404 |
| Investment in affiliate, at equity (Note 7) | 451,520 | 440,378 |
| Cash value of life insurance, net | 125,535 | 119,884 |
| Intangible assets | 16,472 | 45,687 |
| | $ 16,652,390 | $ 17,384,705 |
| **Liabilities and Stockholders' Equity** | | |
| **Current liabilities:** | | |
| Short-term borrowings (Note 8) | $ 1,628,000 | $ 3,011,000 |
| Current portion of long-term debt (Note 9) | 238,066 | 247,924 |

| | | |
|---|---|---|
| Payables - trade | **994,057** | 1,315,089 |
| Accrued commissions | **666,323** | 982,741 |
| Other current liabilities | **929,003** | 393,665 |
| Billings in excess of costs and estimated earnings (Note 4) | **18,002** | 95,421 |
| Accrued income taxes | **329,780** | 4,207 |
| **Total current liabilities** | **4,803,231** | 6,050,047 |
| Long-term debt (Note 9) | **282,622** | 514,788 |
| Payables - affiliate (Note 13) | **174,609** | 253,307 |
| Deferred income taxes (Note 11) | **281,585** | 246,200 |
| Minority stockholder's interest | **520,504** | 483,895 |
| **Stockholders' Equity:** | | |
| Common stock, $.025 par value, authorized 8,000,000 shares, issued 3,409,983 and 3,407,156 shares | **85,250** | 85,179 |
| Paid-in capital | **4,745,293** | 4,611,266 |
| Retained earnings | **6,815,378** | 6,196,105 |
| | **11,645,921** | 10,892,550 |
| Treasury stock -264,853 shares at cost | **(1,056,082)** | (1,056,082) |
| **Total stockholders' equity** | **10,589,839** | 9,836,468 |
| | **$ 16,652,390** | $ 17,384,705 |

*See accompanying notes.*

TAYLOR DEVICES, INC. AND SUBSIDIARY

**Consolidated Statements of Income**

| For the years ended May 31, | **2007** | 2006 |
|---|---|---|
| Sales, net (Note 10) | **$ 16,501,400** | $ 14,750,699 |
| Cost of goods sold | **10,746,281** | 10,437,843 |
| **Gross profit** | **5,755,119** | 4,312,856 |
| Selling, general and administrative expenses | **4,411,678** | 3,395,293 |
| **Operating income** | **1,343,441** | 917,563 |
| Other income (expense): | | |
| Interest, net | **(306,789)** | (164,123) |

| | | |
|---|---|---|
| Miscellaneous | **18,088** | 14,256 |
| Total other income (expense) | **(288,701)** | (149,867) |
| Income before provision for income taxes, equity in net income of affiliate and minority stockholder's interest | **1,054,740** | 767,696 |
| Provision for income taxes (Note 11) | **410,000** | 237,500 |
| Income before equity in net income of affiliate and minority stockholder's interest | **644,740** | 530,196 |
| Equity in net income (loss) of affiliate (Note 7) | **11,142** | (11,499) |
| Income before minority stockholder's interest | **655,882** | 518,697 |
| Minority stockholder's interest | **(36,609)** | (32,904) |
| **Net income** | **$ 619,273** | $ 485,793 |
| Basic and diluted earnings per common share (Note 12) | **$ .20** | $ 0.16 |

*See accompanying notes.*

TAYLOR DEVICES, INC. AND SUBSIDIARY

**Consolidated Statements of Stockholders' Equity**

For the years ended May 31, 2007 and 2006

| | Common Stock | Paid-In Capital | Retained Earnings | Treasury Stock |
|---|---|---|---|---|
| Balance, May 31, 2005 | $ 83,596 | $ 4,307,405 | $ 5,710,312 | $ (892,969) |
| Net income for the year ended May 31, 2006 | - | - | 485,793 | - |
| Common stock issued for employee stock purchase plan (Note 14) | 40 | 6,663 | - | - |
| Common stock issued for employee stock option plans (Note 15) | 1,543 | 217,198 | - | (163,113) |
| Tax benefit related to employee stock option plans | - | 80,000 | - | - |

| | | | | |
|---|---|---|---|---|
| **Balance, May 31, 2006** | $ 85,179 | $ 4,611,266 | $ 6,196,105 | $ (1,056,082) |
| Net income for the year ended May 31, 2007 | - | - | 619,273 | - |
| Common stock issued for employee stock purchase plan (Note 14) | 71 | 15,238 | - | - |
| Stock options issued for services (Notes 1 and 15) | - | 118,789 | - | - |
| **Balance, May 31, 2007** | **$ 85,250** | **$ 4,745,293** | **$ 6,815,378** | **$ (1,056,082)** |

*See accompanying notes.*

TAYLOR DEVICES, INC. AND SUBSIDIARY

**Consolidated Statements of Cash Flows**

| For the years ended May 31, | **2007** | 2006 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | **$ 619,273** | $ 485,793 |
| Adjustments to reconcile net income to net cash flows from operating activities: | | |
| Depreciation and amortization | **350,512** | 319,870 |
| Stock options issued for services | **118,789** | - |
| Bad debts expense | **45,000** | 54,157 |
| Provision for inventory obsolescence | **165,000** | 140,000 |
| Equity in net (income) loss of affiliate | **(11,142)** | 11,499 |
| Deferred income taxes | **(3,000)** | 11,485 |
| Minority stockholder's interest | **36,609** | 32,904 |
| Tax benefit related to employee stock option plans | **-** | 80,000 |
| Changes in other assets and liabilities: | | |
| Accounts receivable | **(1,515,365)** | 241,317 |
| Inventory | **(1,252,281)** | 532,896 |
| Prepaid expenses | **(82,520)** | 83,254 |
| Prepaid income taxes | **224,698** | (224,698) |
| Costs and estimated earnings in excess of billings | **3,071,111** | (3,405,124) |
| Payables - trade | | |

| | | | |
|---|---|---|---|
| | | **(321,032)** | 544,759 |
| | Accrued commissions | **(316,418)** | 406,191 |
| | Other current liabilities | **535,338** | 56,775 |
| | Billings in excess of costs and estimated earnings | **(77,419)** | (192,582) |
| | Accrued income taxes | **325,573** | (45,489) |
| | **Net cash flows from (for) operating activities** | **1,912,726** | (866,993) |
| **Cash flows from investing activities:** | | | |
| | Net cash paid to trustee | **(4,222)** | (332) |
| | Acquisition of property and equipment | **(251,703)** | (253,202) |
| | Increase in cash value of life insurance | **(5,651)** | (5,595) |
| | **Net cash flows for investing activities** | **(261,576)** | (259,129) |
| **Cash flows from financing activities:** | | | |
| | Net short-term borrowings | **(1,383,000)** | 1,621,000 |
| | Payments on long-term debt | **(242,024)** | (223,926) |
| | Payables - affiliate | **(78,698)** | (336,669) |
| | Proceeds from issuance of common stock | **15,309** | 225,444 |
| | Acquisition of treasury stock | **-** | (163,113) |
| | **Net cash flows from (for) financing activities** | **(1,688,413)** | 1,122,736 |
| | Net decrease in cash and cash equivalents | **(37,263)** | (3,386) |
| Cash and cash equivalents - beginning | | **60,011** | 63,397 |
| | Cash and cash equivalents - ending | **$ 22,748** | $ 60,011 |

*See accompanying notes.*

TAYLOR DEVICES, INC. AND SUBSIDIARY

**Notes to Consolidated Financial Statements**

**1. Summary of Significant Accounting Policies:**

**Nature of Operations:**

Taylor Devices, Inc. (the Company) is primarily engaged in the manufacture and sale of tension control, energy storage and shock absorption devices for use in various types of machinery, equipment and structures, primarily to customers which are located throughout the United States and several foreign countries. The products are manufactured at the Company's sole operating facility in the United States where all of the Company's long-lived assets reside. The Company does not track sales by category within this group of products.

72% of the Company's 2007 revenue is generated from sales to customers in the United States and 23% is from sales to customers in Asia. Remaining sales are to customers in Europe, South America and Australia.

53% of the Company's 2006 revenue is generated from sales to customers in the United States and 44% is from sales to customers in Asia. Remaining sales are to customers in Europe.

**Principles of Consolidation:**

The accompanying consolidated financial statements include the accounts of the Company and its 58% owned subsidiary, Tayco Realty Corporation (Realty). Minority stockholder's interest represents Tayco Developments, Inc.'s (Developments) 42% ownership interest in Realty. The Company considers the principles of Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46(R), Consolidation of Variable Interest Entities and Accounting Research Bulletin No. 51, Consolidation of Financial Statements when determining whether an entity is subject to consolidation. After such consideration, the Company otherwise accounts for its investments in companies over which it has the ability to exercise significant influence under the equity method if the Company holds 50% or less of the voting stock.

The Company's investment in its minority-owned affiliate, Developments, is reported on the equity method (see Note 7). Developments is a patent holding company engaged in research, development and licensing for use in the manufacturing operations of the Company.

All inter-company transactions and balances have been eliminated in consolidation.

**Use of Estimates:**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**Cash Equivalents and Short Term Investments:**

The Company includes all highly liquid investments in money market funds in cash and cash equivalents on the accompanying balance sheets.

Cash and cash equivalents in financial institutions may exceed insured limits at various times during the year and subject the Company to concentrations of credit risk.

**Accounts Receivable:**

Accounts receivable are stated at an amount management expects to collect from outstanding balances. Management provides for probable uncollectible accounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

**Inventory:**

Inventory is stated at the lower of average cost or market. Average cost approximates first-in, first-out cost.

**Property and Equipment:**

Property and equipment is stated at cost net of accumulated depreciation. Deprecation is provided primarily using the straight-line method for financial reporting purposes, and accelerated methods for income tax reporting purposes. Maintenance and repairs are charged to operations as incurred; significant improvements are capitalized.

**Cash Value of Life Insurance:**

Cash value of life insurance is stated at the surrender value of the contracts less outstanding policy loans.

**Intangible Assets:**

Intangible assets consist of financing costs associated with obtaining new financing and are capitalized and amortized over the repayment terms of the related debt obligations.

**Revenue Recognition:**

Sales are recognized when units are delivered or services are performed. Sales under fixed-price contracts are recorded as deliveries are made at the contract sales price of the units delivered. Sales under certain fixed-price contracts requiring substantial performance over several periods prior to commencement of deliveries, are accounted for under the percentage-of-completion method of accounting whereby revenues are recognized based on estimates of completion prepared on a ratio of cost to total estimated cost basis. Costs include all material and direct and indirect charges related to specific contracts. Other expenses are charged to operations as incurred. Total estimated costs for each of the contracts are estimated based on a combination of historical costs of manufacturing similar products and estimates or quotes from vendors for supplying parts or services towards the completion of the manufacturing process. Adjustments to cost estimates are made periodically, and losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. If total costs calculated upon completion of the manufacturing process in the current period for a contract are more than the estimated total costs at completion used to calculate revenue in a prior period, then the revenue and profits in the current period will be lower than if the estimated costs used in the prior period calculation were equal to the actual total costs upon completion.

For financial statement presentation purposes, the Company nets progress billings against the total costs incurred on uncompleted contracts. The asset, "costs and estimated earnings in excess of billings," represents revenues recognized in excess of amounts billed. The liability, "billings in excess of costs and estimated earnings," represents billings in excess of revenues recognized.

**Shipping and Handling Costs:**

Shipping and handling costs are classified as a component of cost of goods sold.

**Income Taxes:**

The provision for income taxes provides for the tax effects of transactions reported in the financial statements regardless of when such taxes are payable. Deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the tax and financial statement basis of assets and liabilities. Deferred taxes are based on tax laws currently enacted with tax rates expected to be in effect when the taxes are actually paid or recovered.

**Stock-Based Compensation:**

On June 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standard(SFAS) No. 123 (revised 2004), *Share-Based Payment: an amendment of FASB Statements No. 123 and 95*(SFAS No. 123R). SFAS No. 123R requires entities to measure compensation cost arising from the grant of share-based payments to employees at fair value and to recognize such cost in income over the period during which the employee is required to provide service in exchange for the award, usually the vesting period. The Company selected the modified prospective method for implementing SFAS 123R and began applying the provisions to stock-based awards granted on or after June 1, 2006.

For the year ended May 31, 2006, the Company had previously adopted the provisions of SFAS No. 123, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure* through disclosure only and accounted for its stock-based employee compensation plans under APB Opinion No. 25. Accordingly, no compensation cost was recorded as all options granted had an exercise price equal to the fair market value of the underlying common stock on the date of the grant.

Had 2006 compensation cost for the stock options plans been determined based on the fair value recognition provisions of SFAS No. 123R, the Company's net income and earnings per share, net of related tax effects, would have been reduced to the proforma amounts indicated below:

| | **2006** |
|---|---|
| Net income: | |
| As reported | **$ 485,793** |
| Pro forma | **$ 377,619** |
| Basic and diluted earnings per common share: | |
| As reported | **$ .16** |
| Pro forma | **$ .12** |

**Reclassifications:**

The 2006 financial statements have been reclassified to conform with the presentation adopted for 2007.

**New Accounting Standards:**

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs - an amendment of ARB No. 43 Chapter 4*. This statement requires abnormal production costs such as idle facility expense, excessive spoilage, rehandling costs and abnormal freight to be excluded from inventory costing and treated as period expenses. In addition, this standard requires the allocation of fixed production overhead to be based on normal capacity of the production facility. The adoption of this standard in 2006 did not have a significant effect on our results.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment: an amendment of FASB Statements No. 123 and 95* (SFAS No. 123R). SFAS No. 123R requires all share-based payments to employees, including grants of stock options, to be recognized in the financial statements based on their fair value. Implementation of the pronouncement was required no later than the beginning of the first fiscal year beginning after June 15, 2005. The Company adopted this Statement in fiscal 2007. The adoption of this standard in 2007 resulted in additional compensation expense recorded of $118,789. The Company also recorded a deferred tax benefit of $43,100 related to this expense. 2007 basic and diluted earnings per common share decreased by approximately $0.02 as a result of the adoption of this accounting standard.

In June 2006, the FASB issued FIN 48 "*Accounting for Uncertainty in Income Taxes*." This interpretation requires the recognition of the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. Implementation of the provisions of FIN 48 is required no later than the beginning of the first fiscal year beginning after December 15, 2006. The Company will adopt FIN 48 as of June 1, 2007, as required. The Company does not expect the adoption of this interpretation to have a material impact on the Company's financial statements.

In September 2006, the FASB issued SFAS No. 157 "*Fair Value Measurements*," to define fair value, establish a framework for measuring fair value in accordance with generally accepted accounting principles, and expand disclosures about fair value measurements. SFAS No. 157 will be effective for fiscal years beginning after November 15, 2007. The Company is assessing the impact the adoption of SFAS No. 157 will have on the Company's consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159 "*The Fair Value Option for Financial Assets and Financial Liabilities - an Amendment of SFAS No. 115."* This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by mitigating volatility in reporting earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 will be effective for fiscal years beginning after November 15, 2007. The Company is assessing the impact the adoption of SFAS No. 159 will have on the Company's consolidated financial position and results of operations.

Other recently issued FASB Statements or Interpretations, SEC Staff Accounting Bulletins, and AICPA Emerging Issue Task Force Consensuses have either been implemented or are not applicable to the Company.

**2. Accounts Receivable:**

| | **2007** | 2006 |
|---|---|---|
| Customers | **$ 3,469,485** | $ 2,153,621 |
| Customers - retention | **556,870** | 374,307 |
| Other | **18,438** | 1,500 |
| | **4,044,793** | 2,529,428 |
| Less allowance for doubtful accounts | **151,000** | 106,000 |
| | **$ 3,893,793** | $ 2,423,428 |

**3. Inventory:**

| | **2007** | 2006 |
|---|---|---|
| Raw materials | **$ 425,162** | $ 413,228 |
| Work-in-process | **4,221,174** | 3,403,680 |
| Finished goods | **546,810** | 499,725 |
| | **5,193,146** | 4,316,633 |
| Less allowance for obsolescence | **100,000** | 100,000 |
| | **$ 5,093,146** | $ 4,216,633 |

**4. Costs and Estimated Earnings on Uncompleted Contracts:**

| | **2007** | 2006 |
|---|---|---|
| Costs incurred on uncompleted contracts | **$ 3,256,594** | $ 4,901,811 |
| Estimated earnings | **1,802,304** | 2,809,940 |

| | | |
|---|---|---|
| | **5,058,898** | 7,711,751 |
| Less billings to date | **3,085,717** | 2,744,878 |
| | **$ 1,973,181** | $ 4,966,873 |

Amounts are included in the accompanying balance sheets under the following captions:

| | **2007** | 2006 |
|---|---|---|
| Costs and estimated earnings in excess of billings | **$ 1,991,183** | $ 5,062,294 |
| Billings in excess of costs and estimated earnings | **18,002** | 95,421 |
| | **$ 1,973,181** | $ 4,966,873 |

**5. Maintenance and Other Inventory:**

| | **2007** | 2006 |
|---|---|---|
| Maintenance and other inventory | **$ 1,611,677** | $ 1,420,052 |
| Less allowance for obsolescence | **857,852** | 876,995 |
| | **$ 753,825** | $ 543,057 |

Maintenance and other inventory represent stock that is estimated to have a product life-cycle in excess of twelve-months. This stock represents certain items the Company is required to maintain for service of products sold, and items that are generally subject to spontaneous ordering.

This inventory is particularly sensitive to technical obsolescence in the near term due to its use in industries characterized by the continuous introduction of new product lines, rapid technological advances and product obsolescence. Therefore, management of the Company has recorded an allowance for potential inventory obsolescence.

The provision for potential inventory obsolescence was $165,000 and $140,000 for the years ended May 31, 2007 and 2006.

**6. Property and Equipment:**

| | **2007** | 2006 |
|---|---|---|
| Land | **$ 141,483** | $ 141,483 |
| Buildings and improvements | **3,822,616** | 3,785,584 |
| Machinery and equipment | **4,382,653** | 4,223,318 |
| Office furniture and equipment | **584,752** | 541,986 |
| Autos and trucks | **75,229** | 75,229 |
| | **9,006,733** | 8,767,600 |
| Less accumulated depreciation | **5,656,923** | 5,348,196 |
| | **$ 3,349,810** | $ 3,419,404 |

Depreciation expense was $321,297 and $311,470 for the years ended May 31, 2007 and 2006.

The following is a summary of property and equipment included above which is held under capital leases:

| | **2007** | 2006 |
|---|---|---|
| Buildings and improvements | **$ 806,707** | $ 806,707 |
| Machinery and equipment | **722,915** | 722,915 |
| Office furniture and equipment | **102,985** | 102,985 |
| | **1,632,607** | 1,632,607 |
| Less accumulated amortization | **1,007,893** | 969,504 |
| | **$ 624,714** | $ 663,103 |

Minimum future lease payments under capital leases as of May 31, 2007 for each of the next five years and in the aggregate are included in long-term debt (see Note 9).

Amortization of property and equipment under the capital leases included in depreciation expense is $38,389 and $49,047 for the years ended May 31, 2007 and 2006.

**7. Investment in Affiliate:**

Investment in affiliate consists of the Company's 23% ownership interest in common shares of Developments acquired at a cost of $85,619, plus the Company's cumulative equity in the net income of Developments of $365,901 and $354,759 through the years ended May 31, 2007 and 2006. The Pink Sheets OTC quoted market value of the Company's common shares of Developments at May 31, 2007 and 2006 was $861,897

and $867,605.

The Company's maximum exposure to loss as a result of its involvement with Developments represents the balance of the Company's equity investment in Developments.

**8. Short-Term Borrowings:**

The Company has available a $5,000,000 bank demand line of credit with interest payable at the Company's option of 30, 60 or 90 day LIBOR rate plus 2.25% or the bank's prime rate less ..25%. The line is secured by accounts receivable, equipment, inventory, and general intangibles. This line of credit is subject to the usual terms and conditions applied by the bank, and is subject to renewal annually. The amount outstanding under this line at May 31, 2007 was $1,628,000, all of which was payable at the bank's prime rate less .25% (8% at May 31, 2007). The total amount outstanding at May 31, 2006 was $3,011,000.

The Company uses a cash management facility under which the bank draws against the available line of credit to cover checks presented for payment on a daily basis. Outstanding checks under this arrangement totaled $18,358 and $271,279 as of May 31, 2007 and 2006. These amounts are included in accounts payable.

**9. Long-Term Debt:**

| | **2007** | 2006 |
|---|---|---|
| Bank term note, monthly payments of $13,713 including interest at 7.19%, secured by substantially all assets of the Company, with the remaining unpaid principal balance payable in October 2008. | **$ 224,787** | $ 367,237 |
| Industrial Revenue Development Bonds, annual principal payments ranging from $25,000 to $150,000 through June 2009 plus interest at variable rates based on the highest rated short-term, federally tax exempt obligations (4.3% at May 31, 2007). | **115,000** | 145,000 |
| Bank mortgage note, monthly principal payments of $1,444 plus interest at the bank's prime rate plus 1% (9.25 % at May 31, 2007), secured by related property, with the remaining unpaid principal balance payable in June 2008. | **21,667** | 39,001 |
| Bank mortgage, monthly principal payments of $2,222 plus interest at the bank's prime rate plus 1% (9.25 % at May 31, 2007), secured by substantially all assets of the Company, due February 2013. | **153,334** | 180,000 |
| Other | **5,900** | 31,474 |
| | **520,688** | 762,712 |
| Less current portion | **238,066** | 247,924 |
| | **$ 282,622** | $ 514,788 |

In November 1994, the Company entered into a capital lease agreement with the Niagara County Industrial Development Agency (NCIDA) to finance certain construction costs for additions to its manufacturing/ testing facilities and for the acquisition of machinery and equipment. To finance the project, NCIDA authorized the sale of its Industrial Revenue Development Bonds, in the aggregate principal amount of $1,250,000, under a trust indenture with a bank as trustee. The capital lease obligation is secured by a first mortgage on real estate, project machinery and equipment, and guaranteed by an irrevocable bank letter of credit in the amount of $115,000 as of May 31, 2007.

As of May 31, 2007, $29,978 of funds were held by a trustee, representing an interest-bearing tax-free money fund restricted for principal reduction payments of the Industrial Revenue Development Bond during fiscal year ending May 31, 2008.

The term note and mortgage note are subject to restrictive covenants relating to net working capital, tangible net worth, capital expenditures and interest coverage ratio. The Company is in compliance with all of the covenants as of May 31, 2007.

The aggregate maturities of long-term debt subsequent to May 31, 2007 are:

| | |
|---|---|
| 2008 | **$ 238,066** |
| 2009 | **137,621** |
| 2010 | **71,667** |
| 2011 | **26,667** |
| 2012 | **26,667** |
| Thereafter | **20,000** |
| | **$ 520,688** |

**10. Sales:**

Sales to two customers approximated 24% (15% and 9%, respectively) of net sales for 2007.

**11. Income Taxes:**

| | **2007** | 2006 |
|---|---|---|
| Current tax provision: | | |
| Federal | **$ 395,200** | $ 195,900 |
| State | **17,800** | 30,600 |
| | **413,000** | 226,500 |
| Deferred tax provision (benefit): | | |
| Federal | **(700)** | 7,500 |
| State | **(2,300)** | 3,500 |
| | **(3,000)** | 11,000 |
| | **$ 410,000** | $ 237,500 |

A reconciliation of provision for income taxes at the statutory rate to income tax provision at the Company's effective rate is as follows:

| | **2007** | 2006 |
|---|---|---|
| Computed tax provision at the expected statutory rate | **$ 350,000** | $ 245,700 |
| Effect of graduated Federal rates on subsidiary income | **(10,800)** | (11,200) |
| State income tax - net of Federal tax benefit | **11,400** | 10,400 |
| Tax effect of permanent differences: | | |
| Equity in net (income) loss of affiliate | **(3,800)** | 4,100 |
| Minority shareholder interest | **12,400** | 11,200 |
| Extraterritorial income exclusion | **(8,600)** | (42,900) |
| Other permanent differences | **43,100** | 10,100 |
| Other | **16,300** | 10,100 |
| | **$ 410,000** | $ 237,500 |

Significant components of the Company's deferred tax assets and liabilities consist of the following:

| | **2007** | 2006 |
|---|---|---|
| Deferred tax assets: | | |
| Allowance for doubtful receivables | **$ 54,800** | $ 38,500 |
| Tax inventory adjustment | **104,800** | 50,100 |
| Allowance for obsolete inventory | **347,800** | 354,700 |
| Accrued vacation | **46,300** | 36,900 |
| Accrued professional fees | **-** | 10,200 |
| Accrued commissions | **16,600** | 15,800 |
| Warranty reserve | **55,000** | 31,100 |
| Stock options issued for services | **43,100** | - |

| | | |
|---|---|---|
| Other | **1,000** | 12,815 |
| FMV of stock options in excess of cost | **-** | 80,900 |
| | **669,400** | 631,015 |
| Deferred tax liabilities: | | |
| Excess tax depreciation | **(281,585)** | (246,200) |
| Net deferred tax assets | **$ 387,815** | $ 384,815 |

Realization of the deferred tax assets is dependent on generating sufficient taxable income at the time temporary differences become deductible. The Company provides a valuation allowance to the extent that deferred tax assets may not be realized. A valuation allowance has not been recorded against the deferred tax assets since management believes it is more likely than not that the deferred tax assets are recoverable. The Company considers future taxable income and potential tax planning strategies in assessing the need for a potential valuation allowance. The amount of the deferred tax assets considered realizable however, could be reduced in the near term if estimates of future taxable income are reduced.

Income on undistributed earnings from affiliates and subsidiary are considered to be permanently reinvested, and therefore no provision for deferred income taxes has been recorded.

The Company and its subsidiary file separate Federal and State income tax returns. As of May 31, 2007, the Company had State investment tax credit carryforwards of approximately $175,000 expiring through May 2014.

**12. Earnings Per Common Share:**

Basic earnings per common share is computed by dividing income available to common stockholders by the weighted-average common shares outstanding for the period. Diluted earnings per common share reflects the weighted-average common shares outstanding and dilutive potential common shares, such as stock options.

A reconciliation of weighted-average common shares outstanding to weighted-average common shares outstanding assuming dilution is as follows:

| | **2007** | 2006 |
|---|---|---|
| Average common shares outstanding | **3,143,964** | 3,112,747 |
| Common shares issuable under stock option plans | **8,226** | 10,712 |
| Average common shares outstanding assuming dilution | **3,152,190** | 3,123,459 |

**13. Related Party Transactions:**

Included in cost of sales are research and development expenses charged by Developments for services performed by its research engineers in the amount of $161,610 and $128,820 for the years ended May 31, 2007 and 2006.

Included in selling, general and administrative expenses is royalty expense charged by Developments for the use of patents in the Company's manufacturing operations in the amount of $91,740 and $97,133 for the years ended May 31, 2007 and 2006.

Included in interest expense for the years ended May 31, 2007 and 2006, are $13,459 and $17,629 charged by Developments for non-current liabilities. During the year, the Company issued an unsecured promissory note payable to Developments for $241,956. The outstanding balance at May 31, 2007 is $144,399. Interest, at 8% per year, is payable monthly through June 2008, when any unpaid principal is due.

The Company leases certain office and laboratory facilities to Developments for a current annual rental of $12,000.

**14. Employee Stock Purchase Plan:**

In March 2004, the Company reserved 295,000 shares of common stock for issuance pursuant to a non-qualified employee stock purchase plan. Participation in the employee stock purchase plan is voluntary for all employees of the Company. Purchase of common shares can be made by employee contributions through payroll deductions with a discretionary matching contribution by the Company of a specified percentage of the employees' contributions based on length of employment with the Company. At the end of each calendar quarter, the employer/employee contributions will be applied to the purchase of common shares at fair market value which are then held in the name of the Company as custodian for the employees' shares. These shares are distributed to the employees at the end of each calendar quarter or upon withdrawal from the plan. During the years ended May 31, 2007 and 2006, 2,827 ($4.93 to $6.13 price per share) and 1,576 ($2.99 to $5.72 price per share)

common shares, respectively, were issued to employees. As of May 31, 2007, 246,512 shares were reserved for further issue. The amount of Company matching expense was zero for the years ended May 31, 2007 and 2006.

**15. Stock Option Plans:**

In 2005, the Company adopted a stock option plan which permits the Company to grant both incentive stock options and non-qualified stock options. The incentive stock options qualify for preferential treatment under the Internal Revenue Code. Under this plan, 140,000 shares of common stock have been reserved for grant to key employees and directors of the Company and 52,500 shares have been granted as of May 31, 2007. Under the plan, the option price may not be less than the fair market value of the stock at the time the options are granted. Options vest immediately and expire ten years from the date of grant. Options granted under the Company's previous nonqualified and incentive stock option plans that have not been exercised will expire ten years from the date of grant and are exercisable over the period stated in each option.

Using the Black-Scholes option pricing model, the weighted average estimated fair value of each option granted under the plan was $3.10 during 2007 and $4.62 during 2006. The pricing model uses the assumptions noted in the following table. Expected volatility is based on the historical volatility of the Company's stock. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. The expected life of options granted is derived from previous history of stock exercises from the grant date and represents the period of time that options granted are expected to be outstanding. The Company uses historical data to estimate option exercise and employee termination assumptions under the valuation model. The Company has never paid dividends on its common stock and does not anticipate doing so in the foreseeable future.

| | **2007** | 2006 |
|---|---|---|
| Risk-free interest rate | **3.1%** | 5.125% |
| Expected life in years | **2.5** | 10 |
| Expected volatility | **88%** | 107% |
| Expected dividend yield | **0%** | 0% |

The following is a summary of stock option activity:

| | **Shares** | **Weighted-Average Exercise Price** | **Intrinsic Value** |
|---|---|---|---|
| Outstanding - May 31, 2005 | 110,222 | $ 3.46 | $ 19,198 |
| Options granted | 36,750 | $ 4.97 | |
| Options exercised | 61,722 | $ 3.54 | $ 222,901 |
| Options expired | - | - | |
| Outstanding - May 31, 2006 | 85,250 | $ 4.05 | $ 174,385 |
| Options granted | 38,250 | $ 5.78 | |
| Options exercised | - | - | - |
| Options expired | 36,000 | $ 3.11 | |
| Outstanding - May 31, 2007 | 87,500 | $ 5.20 | $ 59,648 |

We calculated intrinsic value for those options that had an exercise price lower than the market price of our common shares as of the balance sheet dates. The aggregate intrinsic value of outstanding options as of the end of each fiscal year is calculated as the difference between the exercise price of the underlying options and the market price of our common shares for the options that were in-the money at that date (49,250 at May 31, 2007 and 85,250 at May 31, 2006.) The Company's closing stock price was $5.80 and $6.10 as of May 31, 2007 and 2006. As of May 31, 2007, there are 87,500 options available for future grants under the stock option plan. $55,628 and 23,052 shares of the Company's common stock was received from the exercise of share options during the fiscal year ended May 31, 2006. The Company realized a tax benefit of $80,000 from stock options exercised during that period.

The following table summarizes information about stock options outstanding at May 31, 2007:

| | | **Outstanding and Exercisable** | |
|---|---|---|---|
| Range of Exercise Prices | Number of Options | Weighted Average Remaining Years of Contractual Life | Weighted Average Exercise Price |
| $2.00-$3.00 | 10,000 | 7.9 | $2.88 |
| $3.01-$4.00 | 9,250 | 5.9 | $3.15 |
| $4.01-$5.00 | - | - | - |
| $5.01-$6.00 | 55,000 | 9.0 | $5.73 |
| $6.01-$7.00 | 13,250 | 9.2 | $6.17 |
| $2.00-$7.00 | 87,500 | 8.6 | $5.20 |

The following table summarizes information about stock options outstanding at May 31, 2006:

| Outstanding and Exercisable | | | |
|---|---|---|---|
| Range of Exercise Prices | Number of Options | Weighted Average Remaining Years of Contractual Life | Weighted Average Exercise Price |
| $2.00-$3.00 | 35,000 | 6.9 | $2.57 |
| $3.01-$4.00 | 14,250 | 6.2 | $3.18 |
| $4.01-$5.00 | - | - | - |
| $5.01-$6.00 | 36,000 | 8.5 | $5.84 |
| $2.00-$6.00 | 85,250 | 7.5 | $4.05 |

**16. Preferred Stock:**

The Company has 2,000,000 authorized but unissued shares of preferred stock which may be issued in series. The shares of each series shall have such rights, preferences, and limitations as shall be fixed by the Board of Directors.

**17. Treasury Stock:**

There was no change in the amount of treasury stock during the year ended May 31, 2007.

During the year ended May 31, 2006, the Company received 23,052 shares of its own common stock as treasury stock at fair market value in lieu of cash payment from certain employees and directors exercising stock options granted under the Company's stock option plans. The treasury shares were received from the option holders as payment for the purchase price of 48,631 shares of the Company's stock during the year ended May 31, 2006.

**18. Retirement Plan:**

The Company maintains a retirement plan for essentially all employees pursuant to Section 401(k) of the Internal Revenue Code. The Company matches a percentage of employee voluntary salary deferrals subject to limitations. The Company may also make discretionary contributions as determined annually by the Company's Board of Directors. The amount expensed under the plan was $16,538 and $12,763 for the years ended May 31, 2007 and 2006.

**19. Fair Value of Financial Instruments:**

The carrying amounts of cash and cash equivalents, restricted funds held by trustee, accounts receivable, accounts payable, accrued liabilities, and short-term borrowings approximate fair value because of the short maturity of these instruments.

The carrying amount of long-term debt approximates fair value because the interest rates on these instruments fluctuate with market interest rates or the fixed rates are based on current rates offered to the Company for debt with similar terms and maturities.

**20. Cash Flows Information:**

| | **2007** | 2006 |
|---|---|---|
| Interest paid | **$ 312,550** | $ 155,894 |
| Income taxes paid (refunded) | **$(139,952)** | $ 496,687 |