

**Dampers in the
New York City Skyline
at 250 West 55th Street**



President's Letter

Dear Shareholder,

Fiscal year 2013 marked yet another successful year for Taylor Devices. Company sales totaled \$24,729,585, second highest in our corporate history, as compared to \$29,006,812 in 2012 and \$20,906,306 in 2011. Operating income for 2013 was a record \$3,466,662 as compared to \$2,887,081 in 2012 and \$1,482,491 in 2011. Net income also set a record at \$2,547,794, compared to \$2,198,931 in 2012 and \$1,416,509 in 2011.

The lower sales volume in 2013 is due to a reduction in seismic and wind damper dollar volume. This was largely due to a surge in orders for these products in 2012, in the aftermath of major earthquakes in Asia. In comparison to the seismic damper sales reduction, aerospace product sales increased substantially for 2013, representing 33% of all sales compared to 23% in 2012. Industrial product sales also increased substantially to 10% of all sales vs. 6% in 2012. Order backlog at year's end was \$13.1 million, compared to \$17.5 million in 2012, and \$15 million in 2011. This reflects generally shorter lead times for aerospace and industrial products as compared to seismic and wind dampers.

Taylor Devices has always sought to stay on the leading edge of our markets by periodically introducing new and unique technology. In 2013, the Company developed and began testing on full-scale structures a modular wall panel with integral dampers in a patented configuration. This allows wood frame structures to be simply and easily upgraded with enhanced seismic protection. Similarly, the Company has filed for patents on a new concept to allow installation of seismic dampers into open storefronts, parking garages, and related structures that must retain open building bays and entrances. This new "Open Spaces Damping System" is unique in that the dampers and attachments are hidden along the top and sides of the bay, leaving the bay and the floor area entirely open. In addition to these new products being developed for the construction industry, the Company continues work on multiple applications for NASA's next generation launch vehicle for manned space exploration. Hopefully there will also be "spin-offs" from the NASA programs to commercial applications.


This year's Annual Report features a major wind damping project in New York City, the 40-story 250 West 55th Street Tower. This mixed-use building has nearly one million square feet of space and utilizes a unique control system, developed by the engineering firm ARUP, known as a "damped outrigger system." This arrangement of dampers (patent pending, ARUP) works extremely well with Taylor Devices' patented Metal Bellows Hermetically Sealed Dampers, which offer tens of millions of maintenance-free cycles of operation. With the damped outrigger system, the dampers are in continuous motion even under relatively low winds, and the Company's metal bellows dampers offer superior performance under these long-term cyclic conditions.

Also featured in this report are Taylor Devices Precise Positioning Isolators that are used on numerous naval shipboard electronics and weapons systems. This product line has been in continuous production since 1963, with tens of thousands of these isolators used on the warships of many nations. Although the product concept is a half-century old, the isolator design has progressed through four generations technically, with patents obtained on each generation of the isolator.

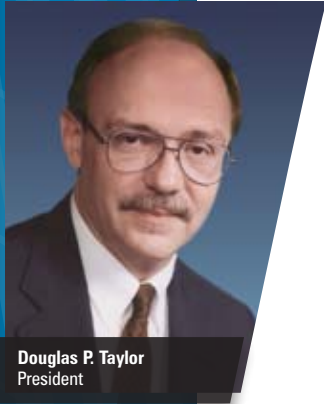
As this Annual Report goes to print, renovation and upgrade work has been completed at the last and largest of the three buildings purchased by the Company in 2011 for expansion of our manufacturing operations. These buildings allow the Company to immediately gain operating efficiency due to the improved material flow and processing, plus they will accommodate for substantial increases in shipment volume in future years.

Sincerely,

TAYLOR DEVICES, INC.



Douglas P. Taylor
President



Douglas P. Taylor
President

Status Report from:

Our Vice President

This past year has been a challenging and satisfying time at Taylor Devices. Profits increased to record levels with the demand for both the Company's seismic products, as well as orders for many non-standard products. The challenge was, would we be able to meet our customer's demands, and the satisfaction was seeing that we did.

At the same time, the Company was developing additional manufacturing space at a site close to the main plant that we now consider our North Campus, located on Buffalo Bolt Way in North Tonawanda, New York. Two of three facilities at the North Campus have been brought online and were in full production as of the end of the fiscal year. This additional capacity has freed us to move one of our finishing operations from a rented space, approximately five miles away, to the closer facilities at the North Campus. The third building, and perhaps the most exciting, will be the machining facility that we will be moving into this coming fall. The Company worked with the School of Engineering at the University at Buffalo in designing the internal layout of this building, giving us what we believe will be a state-of-the-art manufacturing facility. New equipment purchased during this past year, as well as the existing machining machines located at the South Campus plant on Tonawanda Island, will be moved into the facility. This move should be approximately a six-week operation. The layout and space will improve the through-flow and efficiency of the Company. We look forward to the move and the capabilities this new space will give us.

The Company made several purchases this past year of precision, state-of-the-art turning equipment and processing equipment that allows for a greater capacity at a reduced cost. It has allowed us to modify certain manufacturing processes, thus reducing cost and making the Company more competitive. We have also expanded our large unit test capacity to allow for a wider range of test parameters with minimal changes to the machine setup. This was done in response to a request we received from our customers and therefore, we can now offer these customers test capabilities that cannot be found anywhere else. It also reduces the time required in testing multiple units, which improves the Company's competitiveness. These changes, critical to the Company's ability to produce, are central to the Company remaining competitive in today's market.

The demand for individuals to work in manufacturing continues to grow as the available workforce ages. In order to attract individuals to the Company, we must remain competitive, offering an interesting, challenging career. We believe the changes to our facilities and the desire to work with and train Taylor employees can offer an individual that career. The Company will continue to offer these opportunities and expand its workforce, bringing additional employees in at all levels.

The upcoming year will offer challenges, and we believe we are well situated to meet those challenges. The past year was a great success, and we look forward to the coming year.

Our Chief Financial Officer

In fiscal year 2013, Taylor Devices, Inc. enjoyed our second highest sales level ever. Although the top line came in 15% under last year's record sales level, the bottom line surpassed last year's record high profits by 16%. A decrease in sales of seismic protection units in Asia was buffered by increases in sales to customers in the U.S. involved in the construction or retrofitting of buildings and bridges, as well as a 24% increase over last year in sales to customers in aerospace/defense. Sales to customers with industrial applications increased by 33% over last year's level. Improvements in the gross margin absorbed most of the sales decrease and savings in selling expenses helped push operating income 20% higher than last year's level. The record high net income translated to earnings per share of 76 cents for fiscal 2013 compared to 67 cents for the prior year.

The Company's backlog of sales orders at May 31, 2013, is \$13.1 million, down 25% from the backlog at the end of the prior year. Of this, 59% is for customers with aerospace/defense applications and 38% will go to customers with construction applications, while 58% is for domestic customers and 37% will be shipped to Asia. We are encouraged by new sales order activity in the early stages of the new fiscal year.

We are now fully into XBRL reporting as required by the SEC. This new tool for investors allows them to more thoroughly and efficiently analyze Taylor Devices, Inc. and other entities to assist with their investment decisions. We will continue to work with our advisors to keep abreast of changes in the regulations and to remain in compliance with them in order to ensure that accurate, reliable financial and business information is provided to investors and other users of this annual report and our interim reports.



Richard G. Hill
Vice President



Mark V. McDonough
Chief Financial Officer

Status Report from:

Aerospace/Defense Products

Sales in 2013 exceeded expectations with a 24% increase over 2012, more than compensating for last year's 10% decline. In spite of the so-called "sequester," Taylor Devices is still generating new business in the U.S. and in foreign military markets.

Though many U.S. military programs have slowed in 2013 due to budget cuts, Taylor Devices has been fortunate to have existing programs, like the Spade Damper for the M777 Light Weight Howitzer and our continued support of the Virginia Class Submarine program adding to our backlog of orders. Also, Taylor Devices has been able to secure orders on foreign missile defense programs, insulating the company from U.S. budget cuts. Several of our Middle Eastern and Asian allies are working to develop and procure these advanced missile defense systems which, in turn, will result in orders for Taylor Devices in the near future.

Two other orders have far-reaching and long-term promise for Taylor Devices' Military/Aerospace sales – the first being the development contract for the next generation manned spacecraft. Taylor Devices has always been seen as a valued partner in NASA's hi-tech supply chain. Our involvement in the manned space program dates back to the Apollo program of the early 1960s, and we are looking forward to continuing this special partnership. The second is the refueling boom deceleration system on the new KC-46 air tanker program for the U.S. Air Force. Taylor Devices has been supplying this type of equipment for the Air Force since the late 1970s. With this new contract, Taylor Devices will supply boom deceleration systems for the first (18) KC-46 Air Tankers through 2017, with a planned total of 179 aircraft to be produced.

Other highlights this year include the 50 Caliber Machine Gun Mount Recoil Buffer for NATO, C-17 transport aircraft engine trailer suspension struts, and smart bomb control fin dampers.

Though Taylor Devices is anticipating cuts in the U.S. military budget, we are confident that the combination of product mix, technological advantage, and program selection will keep our military sales robust for years to come.

Industrial Products

While the U.S. economy progresses along in another recession and the world economies continue their uncertain progress, the overall sales of Taylor Devices' Industrial Product Lines for FY13 have performed very well, even despite the phenomenal year we had in FY12, and the probability that we would not match that year in sales volume during FY13. While FY12 was an incredible year, it had a profound effect on our future outlook for sales because the surge in work (that year) resulted in our lead times extending beyond normal and expected levels of our seismic dampers for upcoming projects. This caused many engineers and owners to choose traditional strengthening or low-technology alternatives to our products, to suit their desired schedules on new construction projects or retrofits. To improve our lead time and get back on track, we implemented a dual strategy to effectively regain future projects and clients. One was to expand our factory, doubling the size of our previously streamlined facility to allow more space for assembly and finishing of products, while the other, more important improvement was to appropriately bolster our inventory of materials and parts to better support sales and delivery of our seismic dampers. This combination has led to a substantial improvement in our delivery time capability, which has translated into more engineers designing our products into their bridge and building structures and other applications, allowing us to quickly realize the fruits of our labor. Without this inventory of readily available materials and parts allowing faster delivery times, our sales would not have been as solid during FY13. Our plan is to continue this trend to further improve our ability to meet the ever-faster turnaround times desired by clients in the niche market of seismic dampers, where customized products are necessary to suit the characteristics of the structure, the local earthquake, or wind content, and the soil/foundation systems present.

We continue to obtain new orders domestically and throughout the world for our Fluid Viscous Dampers and specialized devices used for structural protection against earthquakes, wind vibration, and pedestrian movements, while our Crane Buffer sales and other industrial product sales have remained solid, but relatively flat.

During FY13, Taylor Devices was awarded contracts to supply Fluid Viscous Dampers for the following significant projects: the new Haramain high speed railway in Saudi Arabia – connecting Mecca and Jeddah; a Boeing airplane hanger facility in Everett, Washington; a residential home in California; the Haneda Airport (Tokyo International Airport) in Japan; the Bnei Zion Hospital in Haifa, Israel; a BART station building retrofit in Pleasant Hill, California; an Apple store in the Stonestown Galleria Mall, San Francisco, California; and an athletic club in Pismo Beach, California. Many other seismic damper projects were also received in FY13 from multiple locations in North America, Europe, Asia, and South America for retrofit and new construction of numerous commercial, residential, and microchip fabrication facility projects, along with a number of new and retrofit bridge projects in these areas.

Our backlog of seismic damper work for FY14 appears appropriate, based on the faster turnaround times desired by clients and our ability to meet these demands. A number of projects are currently in the works and we are ready to support these needs. This gives us cautious optimism for the Industrial Product Lines maintaining resilient sales through FY14. We continue to monitor the domestic and global economies and strive to maintain our flexibility to meet the various needs of our clients.



Paul Tuttobene
Aerospace / Defense
Products Division



Robert H. Schneider
Industrial Products Division



Craig W. Winters
Industrial Products Division

Corporate Information

Corporate Data

OFFICERS AND DIRECTORS

Douglas P. Taylor, President and Director
Richard G. Hill, Vice President and Director
Reginald B. Newman II, Secretary and Director
Randall L. Clark, Director
John Burgess, Director
Mark V. McDonough, Chief Financial Officer

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Lumsden & McCormick, LLP
Cyclorama Building
369 Franklin Street
Buffalo, NY 14202-1702

GENERAL COUNSEL

Hiscock and Barclay, LLP
1100 M&T Center
3 Fountain Plaza
Buffalo, NY 14203-1486

MANAGERS

Lorrie Battaglia, Human Resources Manager
Daniel Grosskopf, Purchasing Manager
Greg Hanson, Small Machine Shop Supervisor
Charles Ketchum III, Quality Assurance Manager
Alan Klembczyk, Chief Engineer
Benjamin Kujawinski, Operations Manager
David Lee, Western Technical Liaison
John Metzger, Engineering Manager Special Projects
David Mooney, Quality Control Manager
Kathleen Nicosia, Shareholder Relations Manager
Robert Schneider, Industrial/Seismic Products Sales Manager
Thomas Struzik Jr., Large Machine Shop Supervisor
Alan Taylor, Government Contracts Manager
Paul Tuttobene, Eastern Technical Liaison
Craig Winters, Industrial/Seismic Products Sales Manager

TRANSFER AGENT AND REGISTRAR

Registrar and Transfer Company
10 Commerce Drive
Cranford, NJ 07016-3572
800.368.5948 • www.rtco.com

- A copy of the financial report on form 10-K can be obtained by written request to the attention of Kathleen Nicosia, IR, at Taylor Devices, Inc., 90 Taylor Drive, North Tonawanda, NY 14120-0748.

Market Information

The Company's Common Stock trades on the NASDAQ Capital Market of the National Association of Securities Dealers Automated Quotation (NASDAQ) stock market under the symbol TAYD.

As of May 31, 2013, the number of issued and outstanding shares of Common Stock was 3,311,035 and the approximate number of record holders of the Company's Common Stock was 732. 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. No cash or stock dividends have been declared during the fiscal year ended May 31, 2013.

The high and low sales information noted below for the quarters of fiscal year 2013 and fiscal year 2012 were obtained from NASDAQ.

	Fiscal 2013		Fiscal 2012	
	High	Low	High	Low
First	\$9.58	\$7.81	\$6.75	\$5.00
Second	\$9.10	\$7.24	\$9.00	\$6.17
Third	\$9.73	\$7.69	\$11.50	\$6.53
Fourth	\$9.00	\$7.58	\$12.18	\$8.51

Notice of Annual Meeting

The annual meeting of the shareholders of the Company will be held on Friday, November 1, 2013, at 11:00 a.m. This year's meeting will be held at the Buffalo Marriott Niagara, 1340 Millersport Highway, Amherst, New York. Shareholders desiring accommodations may call the Buffalo Marriott Niagara at 716.689.6900.

250 West 55th Street Tower

First Viscous Damping System on a New York City Tall Building

Forty-story tower, 988,000 sq. ft. area

Mixed use, including offices and retail, a green roof, two podium levels, and two basement levels.

Dampers are used for wind load reduction and occupant comfort.

Patented Taylor Devices' Metal Bellows Hermetic Dampers used for extreme long life and zero operating friction.

The use of Viscous Dampers over conventional construction saved the owner more than \$5 million in construction costs and nearly 1,000 tons of steel.

Owner – Boston Properties, Inc.

Architect – Skidmore, Owings and Merrill, LLP, NYC

Engineer – ARUP, NYC

Damper Arrangement – ARUP Damped Outrigger System

Opening – 2014-2015

Photos Courtesy: Craig Winters



The Taylor Devices Dampers

Seven dampers rated to 380,000 lb. output and 5 kilowatts peak power each

Damper length = 30 feet

Diameter = 2 feet

Weight each = 4.1 tons

Sealing via frictionless stainless steel metal bellows



Photos Courtesy: Paul Tuttobene

The Installation

Went slowly due to inclement weather and the size of the dampers.

The End Result

A spectacular new building on the Midtown Manhattan skyline.



Board of Directors and Executive Officers

Mr. Taylor holds a B.S. degree in Mechanical Engineering from the State University of New York at Buffalo, awarded in 1971. He has been employed by Taylor Devices, Inc. since 1971, and was appointed President in April 1991. Mr. Taylor previously was President of Tayco Developments, Inc., an affiliate of Taylor Devices, Inc. that was subsequently acquired by merger in 2008, where he had been employed since 1966, and was appointed President in 1991. He is inventor or co-inventor on 32 patents in the fields of energy management, hydraulics, and shock isolation.

Mr. Taylor is widely published within the shock and vibration community. His technical papers have been published by the American Society of Civil Engineers, the Applied Technology Council, the Association of Iron and Steel Engineers, the *Journal of Shock and Vibration*, the National Fluid Power Foundation, the National Science Foundation, the New York State Science and Technology Foundation, the Shock and Vibration Symposium, the Society of Automotive Engineers, the U.S. Air Force, and the U.S. Marine Corps. Since 1988, Mr. Taylor has hosted internship programs for engineering students, affiliated as an industrial sponsor with the State University of New York at Buffalo, the Erie County State of New York Board of Co-operative Educational Services, and the North Tonawanda, New York, Public School System.

Since 1991, Mr. Taylor has participated in research projects in the field of earthquake protection, in association with the University at Buffalo's Civil, Structural, and Environmental Engineering Department and the Multidisciplinary Center for Extreme Events Research. As a result of this research, military technology from the Cold War era is now being used worldwide for seismic and high wind protection of commercial building and bridge structures.

In 1994, Mr. Taylor was named to the American Society of Civil Engineers' Subcommittee on the Seismic Performance of Bridges. In 1998, Mr. Taylor was appointed to an Oversight Committee of the U.S. Department of Commerce, developing guidelines for the implementation of damping technology into buildings and other structures, as part of the U.S. National Earthquake Hazard Reduction Program. In 1998, Mr. Taylor was awarded the Franklin and Jefferson Medal for his commercialization of defense technology developed under the U.S. Government's Small Business Innovation Research Program. In 1999, Mr. Taylor was awarded the Clifford C. Furnas Memorial Award by the Alumni Association of the University at Buffalo for his accomplishments in the field of engineering. In 2006, Mr. Taylor was named to the American Society of Civil Engineers' Blast Protection of Buildings Standards Committee. In 2006, Mr. Taylor was the recipient of the Dean's Award for Engineering Achievement by the School of Engineering and Applied Sciences at the State University of New York at Buffalo. Also in 2006, Mr. Taylor was named Structural Engineer of the Year (2006) by the engineering journal *The Structural Design of Tall and Special Buildings*. Mr. Taylor is a founding member of the International Association on Structural Control and Monitoring. Since 2004, Mr. Taylor has also served as Chairman of the Lumber City Development Corporation, a Type C not-for-profit corporation under Section 501(c)(3) of the Internal Revenue Code. This corporation's purpose is planning and implementation of programs, projects, and activities designed to create or stimulate economic and community development in the city of North Tonawanda, NY.

Mr. Hill holds a B.S. degree in Electrical Engineering from the Rochester Institute of Technology, awarded in 1973. In November 1991, Mr. Hill was appointed Vice President of Taylor Devices, Inc. by the Board of Directors. He had been employed previously by Taylor Devices, Inc. since 1978 as Vice President of Production. In addition, he has held key project management positions with the Company on major aerospace and defense contracts. In April of 1991, Mr. Hill was appointed to the Board of Directors of Taylor Devices, Inc. From 1973 to 1978, Mr. Hill was employed by the Alliance Tool and Die Company of Rochester, New York, as a Project Leader and Design Engineer. From 1970 to 1973, he was employed by the same firm as an Engineer in Training, through a co-op program with the Rochester Institute of Technology.

Mr. Hill has served on the Founding Board of Directors of the Center for Competitiveness of the Niagara Region and the Advisory Board to The Center for Industrial Effectiveness. Mr. Hill served as Chairman for the Manufacturers Council of the Buffalo Niagara Partnership and served on the State University of New York at Buffalo's UB Business Alliance Advisory Board, as well as holding the seat of Secretary.

Mr. Newman received his B.S. degree in Business Administration from Northwestern University in 1959. He was employed by NOCO Energy Corp., a diversified distributor and retailer of petroleum and other energy related products from 1960, retiring in 2003. Mr. Newman is also Chairman of Prior Aviation Service, Inc., Buffalo, New York.

From 1959 to 1960, Mr. Newman was employed by the Ford Motor company of Dearborn, Michigan, in the product planning department.

Mr. Newman is currently a Director of Dunn Tire LLC and a Director and Chairman of Rand Capital Corporation. He was the Chair of the Board of Trustees of the University at Buffalo Foundation, Inc. from 1996-2008.

Mr. Newman received the 1997 Executive of the Year, awarded by the State University of New York at Buffalo. In 1998, Mr. Newman received the Walter P. Cooke Award for Notable and Meritorious Service to the University presented by the University at Buffalo Alumni Association. He received the President's Medal from the University in 2003, as well as their highest honor, the Norton Medal, in 2006. He is a former member of the Buffalo Niagara Partnership and was Chairman from 1996 through 1998. Mr. Newman was awarded an Honorary Degree from Canisius College in 1997.



Douglas P. Taylor
Board Member
President



Richard G. Hill
Vice President



Reginald B. Newman II
Board Member and Secretary

Board of Directors and Executive Officers

Mr. Clark holds a B.A. degree from the University of Pennsylvania, and earned his M.B.A. from the Wharton School of Finance and Commerce. He is and has been the Chairman of Dunn Tire LLC since 1996. From 1992 to 1996, Mr. Clark was Executive Vice President and Chief Operating Officer of Pratt & Lambert, until it was purchased by Sherwin-Williams.

Mr. Clark has been employed in the tire industry for many years. He was named President of the Dunlop Tire Corporation in 1980, was appointed to the Board of Directors in 1983, and named President and Chief Executive Officer in 1984. He was one of seven chief executives of operating companies appointed to the Group Management Board of Dunlop Holdings, plc., and was Chairman of the Board and Chief Executive Officer of Dunlop Tire Corporation in North America from 1985 to 1991. In 2012, he was inducted into the Tire Industry Association Hall of Fame.

From 1977 to 1980, Mr. Clark was Vice President of Marketing for the Dunlop Tire Division. From 1973 to 1977, he was employed by Dunlop as Director of Marketing at the company's Buffalo, New York, headquarters. From 1968 to 1973, Mr. Clark was employed by the B.F. Goodrich Company.

Mr. Clark is currently a Director of Computer Task Group, a publicly traded company, a Director and former Chairman of Merchants Mutual Insurance Company, and Chairman of Lifetime Healthcare Companies. He is also a Director of Curtis Screw and The Ten Eleven Group. He is a past President of the International Trade Council of Western New York, past Chairman of the Buffalo Chamber of Commerce, Chairman of the Buffalo Niagara Enterprise, and Chairman of Univera Healthcare. He is also a past Chairman of AAA of Western and Central New York. Mr. Clark was appointed by then Governor George Pataki and served on the Council for the State University of New York at Buffalo. Recently he was appointed to the Board of Trustees of the University at Buffalo Foundation.

Mr. Burgess gained his international strategy, manufacturing operations, and organizational development expertise from his more than 35 years of experience with middle market public and privately owned companies. Mr. Burgess served as President and CEO of Reichert, Inc., a leading provider of ophthalmic instruments, and spearheaded the acquisition of the company from Leica Microsystems in 2002, leading the company until its sale in January 2007. Prior to the acquisition, Mr. Burgess served as President of Leica's Ophthalmic and Educational Divisions before leading the buyout of the Ophthalmic Division and formation of Reichert, Inc.

From 1996 to 1999, Mr. Burgess was COO of International Motion Controls (IMC), a \$200 million diversified manufacturing firm. During his tenure there, he led a significant acquisition strategy that resulted in seven completed acquisitions and 16 worldwide businesses in the motion control market. Previously, Mr. Burgess operated a number of companies for Moog, Inc. and Carleton Technologies, including six years as President of Moog's Japanese subsidiary, Nihon Moog K.K. located in Hiratsuka, Japan. Moog, Inc. is the global leader in electro-hydraulic servo control technology with focus on the aerospace and defense sectors and was recognized as one of The 100 Best Companies to Work For in America by *Fortune* magazine.

Mr. Burgess earned a B.S. degree in Engineering from Bath University in England, and an M.B.A. from Canisius College.

Currently Mr. Burgess is an Operating Partner of Summer Street Capital LLC and Director of Bird Technologies Corporation of Solon, Ohio.

Mr. McDonough, who joined Taylor Devices in June 2003, is a Certified Public Accountant in New York State and holds a B.B.A. degree from Niagara University, awarded in 1982. He has been involved in financial management of various Western New York manufacturing organizations for over 20 years. He has extensive experience in international operations, coupled with a long history of implementing systems of internal controls. From 1986 to 1989, he was an auditor with the Buffalo office of Ernst & Young, LLP.

Mr. McDonough is a member of the New York State Society of Certified Public Accountants and the American Institute of Certified Public Accountants.



Randall L. Clark
Board Member



John Burgess
Board Member



Mark V. McDonough
Chief Financial Officer



Fifty Years of Excellence

Taylor Devices Precise Positioning Isolators

In 1963, the Company responded to a U.S. Navy requirement for a self-aligning, bi-directional isolator for shipboard navigation systems. At the time, navigator designs used multiple high-speed mechanical gyroscopes spinning in a vacuum as the reference for the navigator. A basic isolator concept resulted from working closely with engineers at the Sperry Gyroscope Company of Long Island, New York. Unfortunately, the end result was a relatively expensive product using 1960s hydraulic technology, and production was quite minimal. However, by the early 1970s, Taylor Devices had perfected its compact high-pressure liquid spring design, based on fluidic control theory. This allowed the basic isolator design of the 1960s to be made much smaller with far fewer parts. The resulting product, commonly called a Precise Positioning Isolator, was so unique that the design was patented by Taylor Devices, with numerous improvement patents obtained in later years. Initial uses were on U.S. Navy aircraft, followed by subsequent applications on modern ring laser and fiber-optic gyro navigators that replaced the early mechanical gyroscope designs.

Today, tens of thousands of Taylor Devices Precise Positioning Isolators are in service worldwide on naval vessels of all types and sizes. Production applications for this product also include shipboard electronics cabinets, radar systems, missile launchers, individual guided missile canisters, and even entire ship decks.

*First Tension-Compression Isolator, 1963
Manufactured for Sperry Gyroscope Company*



*Tension-Compression Isolator, 1973
Manufactured for Lockheed*



Photos Courtesy: David J. Taylor

*Current Production Tension-Compression Isolators
Manufactured for the U.S. Navy*

TAYLOR DEVICES, INC. AND SUBSIDIARY

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

AND

CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2013

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

Cautionary Statement

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Information in this Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this 10-K 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," "assume" and "optimistic" 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.

Application of Critical Accounting Policies and Estimates

The Company's consolidated financial statements and accompanying notes are prepared in accordance with U.S. generally accepted accounting principles. The preparation of the Company's financial statements requires management to make estimates, assumptions and judgments that affect the amounts reported. These estimates, assumptions and judgments are affected by management's application of accounting policies, which are discussed in Note 1. "Summary of Significant Accounting Policies" and elsewhere in the accompanying consolidated financial statements. As discussed below, our financial position or results of operations may be materially affected when reported under different conditions or when using different assumptions in the application of such policies. In the event estimates or assumptions prove to be different from actual amounts, adjustments are made in subsequent periods to reflect more current information. Management believes the following critical accounting policies affect the more significant judgments and estimates used in the preparation of the Company's financial statements.

Accounts Receivable

Our ability to collect outstanding receivables from our customers is critical to our operating performance and cash flows. 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 after considering the age of each receivable and communications with the customers involved. Balances that are collected, for which a credit to a valuation allowance had previously been recorded, result in a current-period reversal of the earlier transaction charging earnings and crediting a valuation allowance. 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 in the current period. The actual amount of accounts written off over the five year period ended May 31, 2013 equaled less than 0.1% of sales for that period. The balance of the valuation allowance remained constant since May 31, 2009 at the current level of \$42,000. Management does not expect the valuation allowance to materially change in the next twelve months for the current accounts receivable balance.

Inventory

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

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. Based on certain assumptions and judgments made from the information available at that time, we determine the amount in the inventory allowance. If

these estimates and related assumptions or the market changes, we may be required to record additional reserves. Historically, actual results have not varied materially from the Company's estimates.

The provision for potential inventory obsolescence was \$180,000 for each of the years ended May 31, 2013 and 2012.

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 and profit estimates are made periodically due to changes in job performance, job conditions and estimated profitability, including those arising from final contract settlements. These changes may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Any 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. Historically, actual results have not varied materially from the Company's estimates. In the fiscal year ended May 31, 2013, 58% of total revenue recognized was accounted for using the percentage-of-completion method of accounting while the remaining 42% of revenue was recorded as deliveries were made to our customers. In the fiscal year ended May 31, 2012, 77% of total revenue recognized was accounted for using the percentage-of-completion method of accounting while the remaining 23% of revenue was recorded as deliveries were made to our customers.

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.

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. The deferred tax assets relate principally to asset valuation allowances such as inventory obsolescence reserves and bad debt reserves and also to liabilities including warranty reserves, accrued vacation, accrued commissions and others. The deferred tax liabilities relate primarily to differences between financial statement and tax depreciation. 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.

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. In future years the Company will need to generate approximately \$3.1 million of taxable income in order to realize our deferred tax assets recorded as of May 31, 2013 of \$1,063,000. This deferred tax asset balance is 12% (\$112,000) higher than at the end of the prior year. 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. If actual results differ from estimated results or if the Company adjusts these assumptions, the Company may need to adjust its deferred tax assets or liabilities, which could impact its effective tax rate. Historically, actual results have not varied materially from the Company's estimates.

The Company's practice is to recognize interest related to income tax matters in interest income / expense and to recognize penalties in selling, general and administrative expenses.

The Company and its subsidiary file consolidated Federal and State income tax returns. As of May 31, 2013, the Company had State investment tax credit carryforwards of approximately \$142,000 expiring through May 2019.

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, 2013 and 2012

	Increase / (Decrease)
Sales, net	\$ (4,277,000)
Cost of goods sold	\$ (4,175,000)
Selling, general and administrative expenses	\$ (682,000)
Income before provision for income taxes	\$ 511,000
Provision for income taxes	\$ 162,000
Net income	\$ 349,000

For the year ended May 31, 2013 (All figures being discussed are for the year ended May 31, 2013 as compared to the year ended May 31, 2012.)

	Year ended May 31		Change	
	2013	2012	Amount	Percent
Net Revenue	\$24,730,000	\$29,007,000	\$(4,277,000)	-15%
Cost of sales	15,966,000	20,141,000	(4,175,000)	-21%
Gross profit	<u>\$ 8,764,000</u>	<u>\$ 8,866,000</u>	<u>\$ (102,000)</u>	-1%
... as a percentage of net revenues	35%	31%		

The Company's consolidated results of operations showed a 15% decrease in net revenues and an increase in net income of 16%. Gross profit decreased by 1%. Revenue in the prior year was bolstered by record high shipments of Taylor Devices' Seismic Dampers, largely to Asia. Last year's increase in demand for these products had been influenced by major earthquakes in Asia over the past several years. In the current period, revenues accounted for under the percentage-of-completion method of accounting decreased by 35% from the level recorded in the prior year. This decrease is primarily due to less projects in process in the current year (59 in fiscal 2013; 75 in fiscal 2012). Of the 59 projects in process during this year, 16 were still in process at 5/31/13 compared with the prior year when 28 of the 75 projects worked on were still in process at 5/31/12. The average value of these projects in-process at the end of the current fiscal year (\$415,000) decreased by 42% from the projects in-process at the end of the prior fiscal year (\$715,000). The projects in the current year are 52% complete in the aggregate as compared with 61% for those in process at 5/31/12. Revenues recorded for all other product sales increased by 55% from last year. This fluctuation is attributable primarily to an increase in sales to customers in aerospace and defense from the prior year. The gross profit as a percentage of net revenues for the current and prior year periods was 35% and 31%, respectively.

The mix of customers buying our products changed from last year. Sales of the Company's products are made to three general groups of customers: industrial, construction and aerospace / defense. A 32% decrease in sales to construction customers who were seeking seismic / wind protection for either building new buildings and bridges or retrofitting existing buildings and bridges from last year's level was offset, somewhat, by a 24% increase in sales to aerospace / defense customers and a 33% increase in sales to customers using our products in industrial applications. A breakdown of sales to these three general groups of customers is as follows:

	Year ended May 31	
	2013	2012
Industrial	10%	6%
Construction	57%	71%
Aerospace / Defense	33%	23%

At May 31, 2012, we had 151 open sales orders in our backlog with a total sales value of \$17.5 million. At May 31, 2013, we had 108 open sales orders in our backlog and the total sales value is \$13.1 million. \$3.2 million of the current backlog is on projects already in progress. \$8.0 million of the \$17.5 million sales order backlog at May 31, 2012 was in progress at that

date. 59% of the sales value in the backlog is for aerospace / defense customers compared to 38% at the end of fiscal 2012. As a percentage of the total sales order backlog, orders from customers in construction accounted for 38% at May 31, 2013 and 67% at May 31, 2012.

The Company's backlog, revenues, commission expense, gross margins, gross profits, and net income fluctuate from period to period. The changes in the current period, compared to the prior period, are not necessarily representative of future results.

Net revenue by geographic region, as a percentage of total net revenue for fiscal years ended May 31, 2013 and 2012 is as follows:

	Year ended May 31	
	2013	2012
North America	55%	40%
Asia	41%	54%
Other	4%	6%

Selling, General and Administrative Expenses

	Year ended May 31		Change	
	2013	2012	Amount	Percent
Outside Commissions	\$ 858,000	\$1,228,000	\$ (370,000)	-30%
Other SG&A	4,439,000	4,751,000	(312,000)	-7%
Total SG&A	\$5,297,000	\$5,979,000	\$ (682,000)	-11%
... as a percentage of net revenues	21%	21%		

Selling, general and administrative expenses decreased by 11% from the prior year. Outside commission expense decreased 30% from last year's level. This fluctuation was primarily due to the decrease in the level of sales from last year to this. Other selling, general and administrative expenses decreased by 7% from last year. This decrease is primarily attributable to a decrease in estimated employee incentive compensation expense in the current period related to the lower level of sales.

The above factors resulted in operating income of \$3,467,000 for the year ended May 31, 2013, up 20% from the \$2,887,000 in the prior year.

The Company's effective tax rate (ETR) is calculated based upon current assumptions relating to the year's operating results and various tax related items. The ETR for the fiscal year ended May 31, 2013 is 26.4%, slightly more than the ETR for the prior year of 25.4%. A reconciliation of provision for income taxes at the statutory rate to income tax provision at the Company's effective rate is as follows:

	2013	2012
Computed tax provision at the expected statutory rate	\$1,176,000	\$1,003,000
State income tax - net of Federal tax benefit	(3,000)	2,000
Tax effect of permanent differences:		
Research tax credits	(213,000)	(207,000)
Other permanent differences	(30,000)	(27,000)
Other	(18,000)	(21,000)
	<u>\$ 912,000</u>	<u>\$ 750,000</u>

Stock Options

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

The Company measures compensation cost arising from the grant of share-based payments to employees at fair value and recognizes such cost in income over the period during which the employee is required to provide service in exchange for the award. The Company recognized \$110,000 and \$117,000 of compensation cost for the years ended May 31, 2013 and 2012.

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 2012 and April 2013. 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:

	<u>August 2012</u>	<u>April 2013</u>
Risk-free interest rate:	1.875%	2.375%
Expected life of the options:	2.9 years	2.9 years
Expected share price volatility:	43%	44%
Expected dividends:	zero	zero
These assumptions resulted in estimated fair-market value per stock option:	\$2.46	\$2.47

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, 2013 is presented below.

	<u>Number of Options</u>	<u>Weighted- Average Exercise Price</u>
Options outstanding and exercisable at May 31, 2012:	163,750	\$6.30
Options granted:	44,500	\$7.84
Less: Options expired:	1,500	\$6.17
Options outstanding and exercisable at May 31, 2013:	206,750	\$6.63
Closing value per share on NASDAQ at May 31, 2013:		\$8.07

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, 2013 were \$3,293,000 compared to \$1,550,000 in the prior year. The Company has commitments to make capital expenditures of \$496,000 as of May 31, 2013. These purchases are related to the substantial renovation of the new buildings acquired in the fiscal year ended May 31, 2012, as discussed in item 2, above.

The Company has a \$6,000,000 demand line of credit from a bank, with interest payable at the Company's option of 30, 60, 90 or 180 day LIBOR rate plus 2.5% or the bank's prime rate less .25%. There is no outstanding balance at May 31, 2013. There was a \$258,000 principal balance outstanding as of May 31, 2012. The outstanding balance on the line of credit fluctuates as the Company's various long-term projects progress. The line is secured by accounts receivable, equipment, inventory, and general intangibles, and a negative pledge of the Company's real property. This line of credit is subject to the usual terms and conditions applied by the bank and is subject to renewal annually. In conjunction with this line of credit, the Company agreed to the following covenants:

<u>Covenant</u>	<u>Minimum per Covenant</u>	<u>Current Actual</u>	<u>When Measured</u>
Minimum level of working capital	\$3 million	\$13.8 million	Quarterly
Minimum debt service coverage ratio	1.5:1	64:1	Fiscal Year-end

The bank is not committed to make loans under this line of credit and no commitment fee is charged.

The level of cash and cash equivalents has increased significantly from May 31, 2012 (\$74,000) to May 31, 2013 (\$1,998,000). This increase was due to a record high net income along with the changes in the assets and liabilities as

itemized in the consolidated statements of cash flow. The assets that decreased the most from last year to this were accounts receivable and costs and estimated earnings in excess of billings. These changes are discussed below. The Company believes that cash on hand combined with the line of credit should be sufficient to fund its expansion plans described in Item 2 of this Report.

Inventory and Maintenance Inventory

	May 31, 2013		May 31, 2012		Increase / (Decrease)	
Raw materials	\$	583,000	\$	622,000	\$	(39,000) -6%
Work in process		7,876,000		7,112,000		764,000 11%
Finished goods		665,000		638,000		27,000 4%
Inventory		9,124,000 91%		8,372,000 91%		752,000 9%
Maintenance and other inventory		904,000 9%		845,000 9%		59,000 7%
Total		\$10,028,000 100%		\$9,217,000 100%		\$ 811,000 9%
Inventory turnover		1.7		2.7		

Inventory, at \$9,124,000 as of May 31, 2013, is 9% higher than the prior year-end. Of this, approximately 86% is work in process, 7% is finished goods, and 7% is raw materials. All of the current inventory is expected to be consumed or sold within twelve months. The level of inventory will fluctuate from time to time due to the stage of completion of the non-project sales orders in progress at the time.

The Company continues to rework slow-moving inventory, where applicable, to convert it to product to be used on customer orders. There was approximately \$149,000 of slow-moving inventory used during the year ended May 31, 2013. The Company disposed of approximately \$268,000 and \$26,000 of obsolete inventory during the years ended May 31, 2013 and 2012, respectively.

Accounts Receivable, Costs and Estimated Earnings in Excess of Billings (“CIEB) and Billings in Excess of Costs and Estimated Earnings (BIEC”)

	May 31, 2013	May 31, 2012	Increase / (Decrease)	
Accounts receivable	\$ 2,245,000	\$ 5,610,000	\$(3,365,000)	-60%
CIEB	2,458,000	5,492,000	(3,034,000)	-55%
Less: BIEC	172,000	669,000	(497,000)	-74%
Net	\$ 4,531,000	\$10,433,000	\$(5,902,000)	-57%

Number of an average day’s sales outstanding in accounts receivable (DSO)	39	52
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The Company combines the totals of accounts receivable, the asset CIEB, and the liability BIEC, 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 \$2,245,000 as of May 31, 2013 includes approximately \$355,000 of amounts retained by customers on long-term construction projects. This retained amount is almost 25% of the amount retained as May 31, 2012. The decrease is simply due to contractual requirements of certain open projects at the year ends. The Company expects to collect all of these amounts, including the retained amounts, during the next twelve months. The number of an average day's sales outstanding in accounts receivable (DSO) decreased from 52 days at May 31, 2012 to 39 days at May 31, 2013. The DSO is a function of 1.) the level of sales for an average day (for example, total sales for the past three months divided by 90 days) and 2.) the level of accounts receivable at the balance sheet date. The level of sales for an average day in the fourth quarter of the current year is just over half of the level in the fourth quarter of the prior year. This is consistent with the overall decrease in revenue for the quarter from the historic high of \$9,643,000 last year to \$5,152,000 this year. The level of accounts receivable at the end of the current year is 60% less than at the end of the prior year. The combination of these two factors caused the DSO to decrease from last year end to this. The decrease in the level of accounts receivable was due to: a.) the decrease in retained amounts on projects, as discussed above and b.) a significant decrease (92%) in the amount of billings to customers on projects in May 2013 over May 2012.

The status of the projects in-progress at the end of the current and prior fiscal years have changed in the factors affecting the year-end balances in the asset CIEB, and the liability BIEC:

	<u>2013</u>	<u>2012</u>
Number of projects in progress at year-end	16	28
Aggregate percent complete at year-end	52%	61%
Average total value of projects in progress at year-end	\$415,000	\$715,000
Percentage of total value invoiced to customer	18%	36%

There are 43% fewer projects in-process at the end of the current fiscal year as compared with the prior year end and the average value of those projects has decreased by 42% between those two dates.

As noted above, CIEB 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 \$2,458,000 balance in this account at May 31, 2013 is a 55% decrease from the prior year-end. 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. 37% of the CIEB balance as of the end of the last fiscal quarter, February 28, 2013, was billed to those customers in the current fiscal quarter ended May 31, 2013. The remainder will be billed as the projects progress, in accordance with the terms specified in the various contracts.

As of May 31, 2013, there are sales orders for nine projects that are not yet in progress. These projects average \$253,000 each in value upon completion. This compares to thirteen such projects as of the prior year end with an average value of \$279,000.

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

	<u>May 31, 2013</u>	<u>May 31, 2012</u>
Costs	\$ 2,752,000	\$ 9,342,000
Estimated earnings	640,000	2,251,000
Less: Billings to customers	934,000	6,101,000
CIEB	<u>\$ 2,458,000</u>	<u>\$ 5,492,000</u>
Number of projects in progress	13	20

As noted above, BIEC represents billings to customers in excess of revenues recognized. The \$172,000 balance in this account at May 31, 2013 is in comparison to a \$669,000 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:

	<u>May 31, 2013</u>	<u>May 31, 2012</u>
Billings to customers	\$ 256,000	\$ 1,107,000
Less: Costs	71,000	328,000
Less: Estimated earnings	13,000	110,000
BIEC	<u>\$ 172,000</u>	<u>\$ 669,000</u>
Number of projects in progress	3	8

The Company's backlog of sales orders at May 31, 2013 is \$13.1 million, down 25% from the backlog at the end of the prior year of \$17.5 million. \$3.2 million of the current backlog is on projects already in progress.

Accounts payable, at \$1,210,000 as of May 31, 2013, is \$2,152,000 less than the prior year-end. There is no specific reason for this fluctuation other than the normal payment cycle of vendor invoices combined with the decreased level of sales orders, resulting in decreased level of purchase orders from the Company to vendors for materials and services to produce our product.

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, 2013 are \$437,000. This is 31% less than the \$631,000 accrued at the prior year-end. Commission expense related to long-term construction projects is recorded

at the same time as revenue on the projects is recorded. This liability has decreased as the progress billings on the projects have been issued by the Company and paid by our customers. Considering that the net change in the balances of accounts receivable and CIEB is a decrease of \$6,400,000 or 58% over the prior year end, it would be reasonable to expect that the balance in the accrued commissions would likewise be lower than the prior year. The Company expects the current accrued amount to be paid during the next twelve months.

Other accrued expenses of \$1,736,000 decreased by 18% from the prior year of \$2,117,000. This decrease is primarily due to a decrease in expenses related to contractual obligations on certain export sales.

Management believes that the Company's cash on hand, 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 (if any) for the next twelve months.

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, 2013 and 2012, and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Taylor Devices, Inc. and Subsidiary as of May 31, 2013 and 2012, 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.



Buffalo, New York
August 2, 2013

TAYLOR DEVICES, INC. AND SUBSIDIARY

Consolidated Balance Sheets

May 31,	2013	2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,997,874	\$ 73,952
Accounts receivable, net (Note 2)	2,244,575	5,610,328
Inventory (Note 3)	9,124,186	8,372,535
Prepaid expenses	299,776	482,317
Prepaid income taxes	157,137	-
Costs and estimated earnings in excess of billings (Note 4)	2,457,822	5,492,028
Deferred income taxes (Note 10)	1,062,600	950,400
Total current assets	17,343,970	20,981,560
Maintenance and other inventory, net (Note 5)	904,299	844,834
Property and equipment, net (Note 6)	7,211,162	4,481,953
Cash value of life insurance, net	159,078	153,550
	\$ 25,618,509	\$ 26,461,897
Liabilities and Stockholders' Equity		
Current liabilities:		
Short-term borrowings (Note 7)	\$ -	\$ 258,000
Current portion of long-term debt (Note 8)	-	3,657
Accounts payable	1,209,597	3,361,742
Accrued commissions	436,732	631,221
Other accrued expenses	1,736,357	2,116,755
Billings in excess of costs and estimated earnings (Note 4)	171,881	668,900
Accrued income taxes	-	140,977
Total current liabilities	3,554,567	7,181,252
Deferred income taxes (Note 10)	398,185	283,985
Stockholders' Equity:		
Common stock, \$.025 par value, authorized 8,000,000 shares, issued 3,841,178 and 3,839,819 shares	96,029	95,995
Paid-in capital	7,397,963	7,276,694
Retained earnings	16,670,748	14,122,954
	24,164,740	21,495,643
Treasury stock - 530,143 ,shares at cost	(2,498,983)	(2,498,983)
Total stockholders' equity	21,665,757	18,996,660
	\$ 25,618,509	\$ 26,461,897

See notes to consolidated financial statements.

TAYLOR DEVICES, INC. AND SUBSIDIARY

Consolidated Statements of Income

For the years ended May 31,	2013	2012
Sales, net (Note 9)	\$ 24,729,585	\$ 29,006,812
Cost of goods sold	15,965,255	20,140,382
Gross profit	8,764,330	8,866,430
Selling, general and administrative expenses	5,297,668	5,979,349
Operating income	3,466,662	2,887,081
Other income (expense):		
Interest, net	(45,460)	28,435
Miscellaneous	38,592	33,415
Total other income (expense)	(6,868)	61,850
Income before provision for income taxes	3,459,794	2,948,931
Provision for income taxes (Note 10)	912,000	750,000
Net income	\$ 2,547,794	\$ 2,198,931
Basic earnings per common share (Note 11)	\$ 0.77	\$ 0.67
Diluted earnings per common share (Note 11)	\$ 0.76	\$ 0.67

See notes to consolidated financial statements.

TAYLOR DEVICES, INC. AND SUBSIDIARY

Consolidated Statements of Stockholders' Equity

For the years ended May 31, 2013 and 2012

	Common Stock	Paid-In Capital	Retained Earnings	Treasury Stock
Balance, May 31, 2011	\$ 93,321	\$ 6,627,463	\$ 11,924,023	\$ (2,261,702)
Net income for the year ended May 31, 2012	-	-	2,198,931	-
Common stock issued for employee stock option plan (Note 14)	2,637	521,481	-	(187,514)
Common stock issued for employee stock purchase plan (Note 13)	37	10,988	-	-
Company buy-back of Treasury shares	-	-	-	(49,767)
Stock options issued for services	-	116,762	-	-
Balance, May 31, 2012	95,995	7,276,694	14,122,954	(2,498,983)
Net income for the year ended May 31, 2013	-	-	2,547,794	-
Common stock issued for employee stock purchase plan (Note 13)	34	11,683	-	-
Stock options issued for services	-	109,586	-	-
Balance, May 31, 2013	\$ 96,029	\$ 7,397,963	\$ 16,670,748	\$ (2,498,983)

See notes to consolidated financial statements.

TAYLOR DEVICES, INC. AND SUBSIDIARY

Consolidated Statements of Cash Flows

For the years ended May 31,	2013	2012
Operating activities:		
Net income	\$ 2,547,794	\$ 2,198,931
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation	564,262	482,152
Stock options issued for services	109,586	116,762
Provision for inventory obsolescence	180,000	180,000
Deferred income taxes	2,000	(126,000)
Changes in other current assets and liabilities:		
Accounts receivable	3,365,753	(3,473,480)
Inventory	(991,116)	(3,198,768)
Prepaid expenses	182,541	57,583
Prepaid income taxes	(157,137)	239,030
Costs and estimated earnings in excess of billings	3,034,206	(1,302,229)
Accounts payable	(2,152,145)	2,069,647
Accrued commissions	(194,489)	197,866
Other accrued expenses	(380,398)	787,414
Billings in excess of costs and estimated earnings	(497,019)	516,395
Accrued income taxes	(140,977)	140,977
Net operating activities	5,472,861	(1,113,720)
Investing activities:		
Acquisition of property and equipment	(3,293,471)	(1,550,659)
Increase in cash value of life insurance	(5,528)	(5,580)
Net investing activities	(3,298,999)	(1,556,239)
Financing activities:		
Net short-term borrowings	(258,000)	258,000
Payments on long-term debt	(3,657)	(5,485)
Proceeds from issuance of common stock	11,717	347,629
Acquisition of treasury stock	-	(49,767)
Net financing activities	(249,940)	550,377
Net change in cash and cash equivalents	1,923,922	(2,119,582)
Cash and cash equivalents - beginning	73,952	2,193,534
Cash and cash equivalents - ending	\$ 1,997,874	\$ 73,952

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies:

Nature of Operations:

Taylor Devices, Inc. (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 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. Management does not track or otherwise account for sales broken down by these categories.

54% of the Company's 2013 revenue was generated from sales to customers in the United States and 41% was from sales to customers in Asia. Remaining sales were to customers in other countries in North America, Europe, South America and Australia.

39% of the Company's 2012 revenue was generated from sales to customers in the United States and 54% was from sales to customers in Asia. Remaining sales were to customers in other countries in North America, Europe, and South America.

Principles of Consolidation:

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Tayco Realty Corporation (Realty). All inter-company transactions and balances have been eliminated in consolidation.

Subsequent Events:

The Company has evaluated events and transactions for potential recognition or disclosure in the financial statements through the date the financial statements were issued.

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 and Cash Equivalents:

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. Depreciation 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.

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. In the fiscal year ended May 31, 2013, 58% of total revenue recognized was accounted for using the percentage-of-completion method of accounting while the remaining 42% of revenue was recorded as deliveries were made to our customers. In the fiscal year ended May 31, 2012, 77% of total revenue recognized was accounted for using the percentage-of-completion method of accounting while the remaining 23% of revenue was recorded as deliveries were made to our customers.

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 selling, general and administrative expenses. These costs for the fiscal year ended May 31, 2012 have been reclassified from cost of goods sold to selling, general and administrative expenses to conform with the presentation for 2013. The amount of these costs were \$715,031 and \$802,147 for the fiscal years ended May 31, 2013 and 2012, respectively.

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.

The Company's practice is to recognize interest related to income tax matters in interest income / expense and to recognize penalties in selling, general and administrative expenses. The Company did not have any accrued interest or penalties included in its consolidated balance sheets at May 31, 2013 or 2012. The Company recorded no interest expense or penalties in its consolidated statements of income during the years ended May 31, 2013 and 2012.

The Company's tax returns for the fiscal tax years ended May 31, 2013 and 2012 will be subject to examination by federal and state tax authorities. During 2011, the Company's tax returns for the years ended May 31, 2007 through 2010 were examined by Federal taxing authorities. The examinations resulted in no changes to the originally filed returns. Accordingly, no further examination of those tax returns is permitted. Additionally, the Company believes it is no longer subject to examination by state taxing authorities for fiscal years prior to May 31, 2010.

Sales Taxes:

Certain jurisdictions impose a sales tax on Company sales to nonexempt customers. The Company collects these taxes from customers and remits the entire amount as required by the applicable law. The Company excludes from revenues and expenses the tax collected and remitted.

Stock-Based Compensation:

The Company measures compensation cost arising from the grant of share-based payments to employees at fair value and recognizes such cost in income over the period during which the employee is required to provide service in exchange for the award. The stock-based compensation expense for the years ended May 31, 2013 and 2012 was \$109,586 and \$116,762.

New Accounting Standards:

In May 2011, the Financial Accounting Standards Board (FASB) issued an amendment to Accounting Standards Updates (ASU) Topic 820, *Fair Value Measurement*. This amendment improves the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards. Implementation of the amendment was required during interim and annual periods beginning after December 15, 2011. The adoption of this standard in 2012 did not have a significant effect on our results.

Other recently issued Accounting Standards Codification (ASC) guidance has either been implemented or are not significant to the Company.

2. Accounts Receivable:

	2013	2012
Customers	\$ 1,931,178	\$ 4,222,103
Customers - retention	355,421	1,430,249
	<u>2,286,599</u>	<u>5,652,352</u>
Less allowance for doubtful accounts	42,024	42,024
	<u>\$ 2,244,575</u>	<u>\$ 5,610,328</u>

3. Inventory:

	2013	2012
Raw materials	\$ 582,591	\$ 622,243
Work-in-process	7,876,272	7,112,012
Finished goods	765,323	738,280
	<u>9,224,186</u>	<u>8,472,535</u>
Less allowance for obsolescence	100,000	100,000
	<u>\$ 9,124,186</u>	<u>\$ 8,372,535</u>

4. Costs and Estimated Earnings on Uncompleted Contracts:

	2013	2012
Costs incurred on uncompleted contracts	\$ 2,822,541	\$ 9,669,917
Estimated earnings	653,458	2,361,081
	<u>3,475,999</u>	<u>12,030,998</u>
Less billings to date	1,190,058	7,207,870
	<u>\$ 2,285,941</u>	<u>\$ 4,823,128</u>

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

	2013	2012
Costs and estimated earnings in excess of billings	\$ 2,457,822	\$ 5,492,028
Billings in excess of costs and estimated earnings	171,881	668,900
	<u>\$ 2,285,941</u>	<u>\$ 4,823,128</u>

5. Maintenance and Other Inventory:

	2013	2012
Maintenance and other inventory	\$ 2,169,148	\$ 2,198,042
Less allowance for obsolescence	1,264,849	1,353,208
	<u>\$ 904,299</u>	<u>\$ 844,834</u>

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 \$180,000 for each of the years ended May 31, 2013 and 2012.

6. Property and Equipment:

	2013	2012
Land	\$ 195,220	\$ 189,083
Buildings and improvements	7,214,445	4,773,388
Machinery and equipment	6,711,011	6,083,178
Office furniture and equipment	1,091,929	962,358
Autos and trucks	73,331	72,702
Land improvements	63,300	-
	<u>15,349,236</u>	<u>12,080,709</u>
Less accumulated depreciation	8,138,074	7,598,756
	<u>\$ 7,211,162</u>	<u>\$ 4,481,953</u>

Depreciation expense was \$564,262 and \$482,152 for the years ended May 31, 2013 and 2012.

7. Short-Term Borrowings:

The Company has a credit facility with a \$6,000,000 demand line of credit from a bank, with interest payable at the Company's option of 30, 60, 90 or 180 day LIBOR rate plus 2.5% or the bank's prime rate less .25%. The line is secured by accounts receivable, equipment, inventory, general intangibles, and a negative pledge of the Company's real property. This line of credit is subject to the usual terms and conditions applied by the bank and subject to renewal annually.

There is no amount outstanding under the line of credit at May 31, 2013. The total amount outstanding on the line of credit at May 31, 2012 was \$258,000.

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 \$113,095 and \$226,413 as of May 31, 2013 and 2012. These amounts are included in accounts payable.

8. Long-Term Debt:

	2013	2012
Total	\$ -	\$ 3,657
Less current portion	-	3,657
	<u>-</u>	<u>-</u>

9. Sales:

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. Sales of the Company's products are made to three

general groups of customers: industrial, construction and aerospace / defense. A breakdown of sales to these three general groups of customers is as follows:

	<u>2013</u>	<u>2012</u>
Construction	\$14,105,072	\$20,597,534
Aerospace / Defense	8,132,008	6,537,566
Industrial	2,492,505	1,871,712
	<u>\$24,729,585</u>	<u>\$29,006,812</u>

Sales to five customers approximated 52% (29%, 7%, 6%, 5% and 5%, respectively) of net sales for 2013. Sales to three customers approximated 49% (41%, 4% and 4%, respectively) of net sales for 2012.

10. Income Taxes:

	<u>2013</u>	<u>2012</u>
Current tax provision (benefit):		
Federal	\$ 911,000	\$ 872,500
State	(1,000)	3,500
	<u>910,000</u>	<u>876,000</u>
Deferred tax provision (benefit):		
Federal	2,000	(125,700)
State	-	(300)
	<u>2,000</u>	<u>(126,000)</u>
	<u>\$ 912,000</u>	<u>\$ 750,000</u>

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

	<u>2013</u>	<u>2012</u>
Computed tax provision at the expected statutory rate	\$1,176,400	\$1,002,700
State income tax - net of Federal tax benefit	(2,900)	2,300
Tax effect of permanent differences:		
Research tax credits	(213,000)	(207,000)
Other permanent differences	(29,800)	(27,200)
Other	(18,700)	(20,800)
	<u>\$ 912,000</u>	<u>\$ 750,000</u>
Effective income tax rate	26.4%	25.4%

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

	<u>2013</u>	<u>2012</u>
Deferred tax assets:		
Allowance for doubtful receivables	\$ 14,400	\$ 14,400
Tax inventory adjustment	209,500	99,200
Allowance for obsolete inventory	465,400	495,200
Accrued vacation	60,200	64,500
Accrued commissions	4,000	9,300
Warranty reserve	126,300	101,000
Stock options issued for services	182,800	166,800
	<u>1,062,600</u>	<u>950,400</u>
Deferred tax liabilities:		
Excess tax depreciation	(398,185)	(283,985)
Net deferred tax assets	<u>\$ 664,415</u>	<u>\$ 666,415</u>

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. The Company will need to generate approximately \$3.1 million in taxable income in future years in order to realize the deferred tax assets recorded as of May 31, 2013 of \$1,062,600.

The Company and its subsidiary file consolidated Federal and State income tax returns. As of May 31, 2013, the Company had State investment tax credit carryforwards of approximately \$142,000 expiring through May 2019.

11. 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:

	<u>2013</u>	2012
Average common shares outstanding	3,310,514	3,269,252
Common shares issuable under stock option plans	46,778	34,363
<u>Average common shares outstanding assuming dilution</u>	<u>3,357,292</u>	<u>3,303,615</u>

12. Related Party Transactions:

The Company had no related party transactions for the years ended May 31, 2013 and 2012.

13. 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 eligible employees of the Company. Purchase of common shares can be made by employee contributions through payroll deductions. At the end of each calendar quarter, the employee contributions will be applied to the purchase of common shares using a share value equal to the mean between the closing bid and ask prices of the stock on that date. 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, 2013 and 2012, 1,359 (\$8.39 to \$8.98 price per share) and 1,477 (\$5.625 to \$10.19 price per share) common shares, respectively, were issued to employees. As of May 31, 2013, 231,380 shares were reserved for further issue.

14. Stock Option Plans:

In 2012, 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, 160,000 shares of common stock have been reserved for grant to key employees and directors of the Company and 16,750 shares have been granted as of May 31, 2013. 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.

Using the Black-Scholes option pricing model, the weighted average estimated fair value of each option granted under the plan was \$2.46 during 2013 and \$2.90 during 2012. 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.

	2013	2012
Risk-free interest rate	2.21%	2.26%
Expected life in years	2.9	2.8
Expected volatility	75%	78%
Expected dividend yield	0%	0%

The following is a summary of stock option activity:

	Shares	Weighted Average Exercise Price	Intrinsic Value
Outstanding - May 31, 2011	229,000	\$ 5.21	\$ 173,570
Options granted	40,250	\$ 8.99	
Less: options exercised	105,500	\$ 4.97	
Outstanding - May 31, 2012	163,750	\$ 6.30	\$ 336,604
Options granted	44,500	\$ 7.84	
Less: options expired	1,500	-	
Outstanding - May 31, 2013	206,750	\$ 6.63	\$ 377,891

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 (181,750 at May 31, 2013 and 138,750 at May 31, 2012.) The Company's closing stock price was \$8.07 and \$9.55 as of May 31, 2013 and 2012. As of May 31, 2013, there are 143,250 options available for future grants under the 2012 stock option plan. \$524,118 was received from the exercise of share options during the fiscal year ended May 31, 2012.

The following table summarizes information about stock options outstanding at May 31, 2013:

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	20,000	4.9	\$2.84	
\$3.01-\$4.00	750	6.2	\$3.51	
\$5.01-\$6.00	71,500	5.1	\$5.59	
\$6.01-\$7.00	45,000	5.8	\$6.25	
\$7.01-\$8.00	30,000	9.9	\$7.74	
\$8.01-\$9.00	14,500	8.9	\$8.06	
\$11.01-\$12.00	25,000	8.9	\$11.29	
\$2.00-\$12.00	206,750	6.6	\$6.63	

The following table summarizes information about stock options outstanding at May 31, 2012:

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	20,000	5.9	\$2.84	
\$3.01-\$4.00	750	7.2	\$3.51	
\$5.01-\$6.00	71,500	6.1	\$5.59	
\$6.01-\$7.00	46,500	6.7	\$6.24	
\$11.01-\$12.00	25,000	9.9	\$11.29	
\$2.00-\$12.00	163,750	6.8	\$6.30	

15. 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.

16. Treasury Stock:

During the year ended May 31, 2012, the Company repurchased 9,200 shares of its common stock for a total of \$49,767, including brokerage fees, under a share repurchase agreement through open market purchases. Purchase prices ranged from \$5.06 to \$6.00 per share.

17. 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 \$72,655 and \$63,016 for the years ended May 31, 2013 and 2012.

18. Fair Value of Financial Instruments:

The carrying amounts of cash and cash equivalents, 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 fixed rates are based on current rates offered to the Company for debt with similar terms and maturities.

19. Cash Flows Information:

	2013	2012
Interest paid	\$ 45,885	\$ -
Income taxes paid	\$ 1,208,114	\$ 496,493

20. Legal Proceedings:

There are no legal proceedings except for routine litigation incidental to the business.

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Notes



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TAYLOR