

ELECTRONIC SYSTEMS TECHNOLOGY INC  
Form 10-Q  
August 11, 2010

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended **June 30, 2010**

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

From \_\_\_\_\_ to \_\_\_\_\_

**ELECTRONIC SYSTEMS TECHNOLOGY, INC.**

(Exact name of registrant as specified in its charter)

**Washington**  
(State or other jurisdiction of incorporation)

**000-27793**  
(Commission File  
Number)

**91-1238077**  
(IRS Employer Identification No.)

**415 N. Quay St. Bldg B1 Kennewick WA**

**99336**

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(Address of principal executive offices)

(Zip Code)

(509) 735-9092

(Registrant's telephone number, including area code)

N/A

(Former name, former address & former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all documents and reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filings for the past 90 days. YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

x

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of June 30, 2010, the number of the Company's shares of common stock par value \$0.001, outstanding was 5,158,667.

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**PART I****FINANCIAL INFORMATION****Item 1. Financial Statements.**

## ELECTRONIC SYSTEMS TECHNOLOGY, INC.

## SELECTED FINANCIAL DATA

(as prepared by Management)

(Unaudited)

| Six Months Ended                             | June 30, 2010 | June 30, 2009 |
|--|---------------|---------------|
| Sales  | \$ 1,027,652  | \$ 972,028    |
| Other Revenues                               | 7,144         | 16,985        |
| Gross Profit                                 | 617,177       | 576,158       |
| Net Income (Loss) Before Taxes               | \$ 20,668     | \$ 39,617     |
| Net Income (Loss) After Taxes                | 19,468        | 36,117        |
| Earnings (Loss) Per Share Before Taxes       |               |               |
| Basic  | \$ 0.00       | \$ 0.01       |
| Diluted                                      | 0.00          | 0.01          |
| Earnings (Loss) Per Share After Taxes        |               |               |
| Basic  | \$ 0.00       | \$ 0.01       |
| Diluted                                      | 0.00          | 0.01          |
| Weighted Average Shares Outstanding (Basic)  |               |               |
| Primary                                      | 5,158,667     | 5,158,667     |
| Diluted                                      | 5,224,630     | 5,158,667     |
| Total Assets                                 | \$ 3,099,778  | \$ 3,096,416  |
| Long-Term Debt and Capital Lease Obligations | \$ 0          | \$ 0          |

|                                |    |           |    |           |
|--------------------------------|----|-----------|----|-----------|
| Shareholders' Equity           | \$ | 2,981,229 | \$ | 2,969,419 |
| Shareholders' Equity Per Share | \$ | 0.58      | \$ | 0.58      |
| Working Capital                | \$ | 2,907,479 | \$ | 2,877,428 |
| Current Ratio                  |    | 29.5:1    |    | 30:1      |
| Equity To Total Assets         |    | 96%       |    | 96%       |

(See "Notes to Financial Statements")

**ELECTRONIC SYSTEMS TECHNOLOGY, INC.****BALANCE SHEETS**

(as prepared by Management)

(Unaudited)

|  | June 30, 2010 | Dec. 31, 2009 |
|--|---------------|---------------|
| <b>ASSETS</b>  |               |               |
| <b>CURRENT ASSETS</b>                                    |               |               |
| Cash and Cash Equivalents                                | \$ 857,281    | \$ 919,608    |
| Short Term Certificates of Deposit Investments           | 1,467,000     | 1,372,000     |
| Accounts Receivable, net of allowance for uncollectibles | 163,020       | 121,993       |
| Inventory  | 476,661       | 503,326       |
| Accrued Interest   | 3,527         | 3,713         |
| Prepaid Federal Income Taxes                             | --            | 20,896        |
| Prepaid Expenses   | 42,139        | 25,816        |
| Total Current Assets                                     | 3,009,628     | 2,967,352     |
| PROPERTY & EQUIPMENT net of depreciation                 | 55,675        | 70,580        |
| OTHER ASSETS   | 1,675         | 340           |
| DEFERRED INCOME TAX BENEFIT                              | 32,800        | 32,600        |
| TOTAL ASSETS   | \$ 3,099,778  | \$ 3,070,872  |
| <b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>            |               |               |
| <b>CURRENT LIABILITIES</b>                               |               |               |
| Accounts Payable   | \$ 54,685     | \$ 33,275     |
| Accrued Liabilities                                      | 46,664        | 56,725        |
| Federal Income Taxes Payable                             | 800           | --            |
| Total Current Liabilities                                | 102,149       | 90,000        |
| DEFERRED INCOME TAX LIABILITY                            | 16,400        | 21,500        |
| <b>STOCKHOLDERS' EQUITY</b>                              |               |               |

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Common Stock, \$.001 Par Value

50,000,000 Shares Authorized

|   |              |              |
|---|--------------|--------------|
| 5,158,667 Shares Issued and Outstanding       | 5,159        | 5,159        |
| Additional Paid-in Capital                    | 995,839      | 993,450      |
| Retained Earnings                             | 1,980,231    | 1,960,763    |
|   | 2,981,229    | 2,959,372    |
| TOTAL LIABILITIES AND STOCKHOLDERS'<br>EQUITY | \$ 3,099,778 | \$ 3,070,872 |

(See "Notes to Financial Statements")

**ELECTRONIC SYSTEMS TECHNOLOGY, INC.****STATEMENTS OF OPERATIONS**

(as prepared by Management)

(Unaudited)

|                                   | Three Months Ended |               | Six Months Ended |               |
|-----------------------------------|--------------------|---------------|------------------|---------------|
|                                   | June 30, 2010      | June 30, 2009 | June 30, 2010    | June 30, 2009 |
| SALES                             | \$ 472,623         | \$ 519,899    | \$ 1,027,652     | \$ 972,028    |
| COST OF SALES                     | 197,445            | 213,705       | 410,475          | 395,870       |
| Gross Profit                      | 275,178            | 306,194       | 617,177          | 576,158       |
| <b>OPERATING EXPENSES</b>         |                    |               |                  |               |
| Finance/Administration            | 64,003             | 59,191        | 147,074          | 142,594       |
| Research & Development            | 86,285             | 67,189        | 151,115          | 135,463       |
| Marketing                         | 123,839            | 116,607       | 255,036          | 225,793       |
| Customer Service                  | 24,052             | 25,058        | 50,428           | 49,676        |
| Total Operating Expenses          | 298,179            | 268,045       | 603,653          | 553,526       |
| OPERATING INCOME (LOSS)           | (23,001)           | 38,149        | 13,524           | 22,632        |
| Other Income (expenses)           |                    |               |                  |               |
| Interest/Investment Income        | 3,597              | 6,131         | 7,144            | 16,985        |
| Net Other Income (Expense)        | 3,597              | 6,131         | 7,144            | 16,985        |
| NET INCOME (LOSS) BEFORE TAX      | (19,404)           | 44,280        | 20,668           | 39,617        |
| Provision For Income Tax          | 3,500              | (6,600)       | (1,200)          | (3,500)       |
| NET INCOME (LOSS)                 | \$ (15,904)        | \$ 37,680     | \$ 19,468        | \$ 36,117     |
| Basic Earnings (Loss) Per Share   |                    |               |                  |               |
| Before Tax                        | \$ ( 0.00)         | \$ 0.01       | \$ 0.00          | \$ 0.01       |
| Basic Earnings (Loss) Per Share   |                    |               |                  |               |
| After Tax                         | \$ ( 0.00)         | \$ 0.01       | \$ 0.00          | \$ 0.01       |
| Diluted Earnings (Loss) Per Share |                    |               |                  |               |
| Before Tax                        | \$ ( 0.00)         | \$ 0.01       | \$ 0.00          | \$ 0.01       |



Diluted Earnings (Loss) Per Share

|           |            |         |         |         |
|-----------|------------|---------|---------|---------|
| After Tax | \$ ( 0.00) | \$ 0.01 | \$ 0.00 | \$ 0.01 |
|-----------|------------|---------|---------|---------|

(See "Notes to Financial Statements")

**ELECTRONIC SYSTEMS TECHNOLOGY, INC.****STATEMENTS OF CASH FLOWS**

(as prepared by Management)

(Unaudited)

|  | Six Months Ended |                |
|--|------------------|----------------|
|  | June 30, 2010    | June 30, 2009  |
| <b>CASH FLOWS PROVIDED (USED) IN OPERATING ACTIVITIES:</b> |                  |                |
| Net Income (Loss)  | \$ 19,468        | \$ 36,117      |
| Noncash items included in income:                          |                  |                |
| Depreciation   | 15,956           | 20,071         |
| Prepaid Federal Income Taxes                               | --               | 12,000         |
| Accrued Interest   | 186              | 7,839          |
| Deferred Income Tax  | (5,300)          | (8,500)        |
| Share Based Compensation                                   | 2,389            | 1,575          |
| <b>DECREASE (INCREASE) IN CURRENT ASSETS:</b>              |                  |                |
| Accounts Receivable Net                                    | (41,027)         | (1,635)        |
| Inventory  | 26,665           | 87,686         |
| Federal Income Taxes Receivable                            | 20,896           | 63,842         |
| Prepaid Expenses   | (16,323)         | (14,915)       |
| <b>INCREASE (DECREASE) IN CURRENT LIABILITIES:</b>         |                  |                |
| Accounts Payable and Accrued Expenses                      | 11,349           | 5,449          |
| Accrued Federal Income Taxes                               | 800              | --             |
|  | 35,059           | 209,529        |
| <b>CASH FLOWS PROVIDED (USED) IN INVESTING ACTIVITIES:</b> |                  |                |
| Certificates of Deposit Redeemed (Purchased)               | (95,000)         | 140,000        |
| Additional Vendor Service Deposit                          | (1,335)          | --             |
| Additions To Property And Equipment                        | (1,051)          | --             |
|  | (97,386)         | 140,000        |
| <b>NET INCREASE (DECREASE) IN CASH AND</b>                 |                  |                |
| <b>CASH EQUIVALENTS</b>                                    | <b>(62,327)</b>  | <b>349,529</b> |

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|  |            |            |
|--|------------|------------|
| Cash And Cash Equivalents At Beginning Of Period | 919,608    | 512,800    |
| Cash And Cash Equivalents At Ending of Period    | \$ 857,281 | \$ 862,329 |

SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION:

Cash Paid Year To Date:

|                      |          |      |
|----------------------|----------|------|
| Interest             | \$ 0     | \$ 0 |
| Federal Income Taxes | \$ 5,700 | \$ 0 |

|                                      |      |      |
|--------------------------------------|------|------|
| Cash allocated for Cash Distribution | \$ 0 | \$ 0 |
|--------------------------------------|------|------|

Cash And Cash Equivalents:

|                       |            |            |
|-----------------------|------------|------------|
| Cash                  | \$ 44,936  | \$ 25,079  |
| Money Market Accounts | 812,345    | 837,250    |
|                       | \$ 857,281 | \$ 862,329 |

(See "Notes to Financial Statements")

**ELECTRONIC SYSTEMS TECHNOLOGY, INC.**

**NOTES TO FINANCIAL STATEMENTS**

(as prepared by Management)

(Unaudited)

**NOTE 1 - BASIS OF PRESENTATION**

The financial statements of Electronic Systems Technology, Inc. (the "Company"), presented in this Form 10Q are unaudited and reflect, in the opinion of Management, a fair presentation of operations for the three month and six month periods ended June 30, 2010 and June 30, 2009. All adjustments of a normal recurring nature and necessary for a fair presentation of the results for the periods covered have been made. Certain information and footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principals have been condensed or omitted pursuant to the applicable rules and regulations of the Securities and Exchange Commission. In preparation of the financial statements, certain amounts and balances have been restated from previously filed reports to conform to the format of this quarterly presentation. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Form 10K for the year ended December 31, 2009 as filed with Securities and Exchange Commission.

The results of operations for the three and six months ended June 30, 2010 and June 30, 2009, are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

**NOTE 2 - INVENTORIES**

Inventories are stated at lower of direct cost or market with cost determined using the FIFO (first in, first out) method. Inventories consist of the following:

|                  | June 30    | December 31 |
|------------------|------------|-------------|
|                  | 2010       | 2009        |
| Parts            | \$ 187,853 | \$258,583   |
| Work in progress | 74,225     | 25,327      |
| Finished goods   | 214,583    | 219,416     |

\$ 476,661      \$ 503,326

### **NOTE 3 EARNINGS (LOSS) PER SHARE**

Basic EPS excludes dilution and is computed by dividing income (loss) available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects potential dilution occurring if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. The primary weighted average number of common shares outstanding was 5,158,667 and 5,158,667 for the three months and six months ended June 30, 2010 and 2009. The diluted weighted average number of common shares outstanding for the three month period ending June 30, 2010 and 2009 was 5,224,630 and 5,158,667, respectively.

### **NOTE 4 - STOCK OPTIONS**

As of June 30, 2010, the Company had outstanding stock options, which have been granted periodically to individual employees and directors with no less than three years of continuous tenure with the Company. On February 19, 2010, stock options to purchase shares of the Company's common stock were granted to individual employees and directors with no less than three years continuous tenure. The options granted on February 19, 2010 totaled 195,000 shares under option and have an exercise price of \$0.45 per share.

The options granted on February 19, 2010 may be exercised any time during the period from February 19, 2010 through February 18, 2013. The Company's Form 8-K dated February 19, 2010, as filed with the Securities and Exchange Commission is incorporated herein by reference. All outstanding stock options must be exercised within 90 days after termination of employment.

The fair value of each option award is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in:



|   | 2010   | 2009   | 2008   | 2007   |
|---|--------|--------|--------|--------|
| Dividend yield                          | 0.00%  | 6.06%  | 2.35%  | 1.43%  |
| Expected volatility                     | 93%    | 108%   | 75%    | 39%    |
| Risk-free interest rate                 | 1.38%  | 1.38%  | 2.24%  | 4.40%  |
| Expected term (in years)                | 3      | 3      | 3      | 3      |
| Estimated Fair Value per Option Granted | \$0.30 | \$0.18 | \$0.39 | \$0.21 |

The Company uses historical data to estimate option exercise rates. The option exercise rate for option grants in 2010 through 2005 was 8.25%.

A summary of option activity during the quarter ended June 30, 2010, is as follows:

|                                | Number Outstanding | Weighted-Average Exercise Price Per Share |
|--------------------------------|--------------------|---|
| Outstanding at January 1, 2010 | 565,000            | \$0.60                                    |
| Granted                        | 195,000            | 0.45                                      |
| Exercised                      | --                 | --  |
| Canceled                       | (175,000)          | 0.68                                      |
| Outstanding at June 30, 2010   | 585,000            | 0.52                                      |

For the second quarter of 2010, compensation expense charged against income for stock options was \$1,195 (\$789 after tax). No non-vested share-based compensation arrangements existed as of June 30, 2010.

#### **NOTE 5 - RELATED PARTY TRANSACTIONS**

For the six-month period ended June 30, 2010, services in the amount of \$39,345 were contracted with Manufacturing Services, Inc., of which the current owner, Michael S. Brown and the former owner, Melvin H. Brown, are both currently members of the Board of Directors of Electronic Systems Technology Inc.

#### **NOTE 6 - SEGMENT REPORTING**

Segment information is prepared on the same basis that the Company's management reviews financial information for operational decision making purposes. The Company has two reportable segments, domestic and foreign, based on the geographic location of the customers. Both segments sell radio modem products (requiring an FCC license or license free Ethernet products), related accessories for radio modem products for industrial automation projects, and mobile data computer products. The foreign segment sells the Company's products and services outside the United States.

During the quarter ended June 30, 2010, Domestic customers represented approximately 75% of total net revenues. Foreign customers represented approximately 25% of total net revenues. No sales to a single customer comprised 10% or more of the Company's product sales. Revenues from foreign countries during the second quarter of 2010 consist primarily of revenues from United Arab Emirates, Canada, Jamaica and France.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies, Note 1. Management evaluates performance based on net revenues and operating expenses. Administrative functions such as finance and information systems are centralized. However, where applicable, portions of the administrative function expenses are allocated between the operating segments. The operating segments share the same manufacturing and distributing facilities. Costs of operating the manufacturing plant, equipment, inventory, and accounts receivable are allocated directly to each segment.



**ELECTRONIC SYSTEMS TECHNOLOGY, INC.**  
**Segment Reporting**

Summary financial information for the two reportable segments for the second quarter of 2010 and 2009 is as follows:

|   | <u>Domestic</u> | <u>Foreign</u> | <u>Unallocated<br/>Corporate</u> | <u>Total</u> |
|---|-----------------|----------------|----------------------------------|--------------|
| <b>Three months ended June 30, 2010</b> |                 |                |                                  |              |
| Total sales                             | \$ 352,173      | \$ 120,450     | \$ -                             | \$ 472,623   |
| Total other income                      | 3,597           | -              | -                                | 3,597        |
| Earnings (loss) before tax              | 2,953           | 41,646         | (64,003)                         | (19,404)     |
| Depreciation/amortization               | 7,378           | -              | 617                              | 7,995        |
| Identifiable assets                     | 630,039         | 9,642          | 2,460,097                        | 3,099,778    |
| Net capital expenditures                | 1,051           | -              | -                                | 1,051        |
| <b>Three months ended June 30, 2009</b> |                 |                |                                  |              |
| Total sales                             | \$ 400,795      | \$ 119,104     | \$ -                             | \$ 519,899   |
| Total other income                      | 6,131           | -              | -                                | 6,131        |
| Earnings (loss) before tax              | 60,524          | 42,947         | (59,191)                         | 44,280       |
| Depreciation/amortization               | 9,399           | -              | 637                              | 10,036       |
| Identifiable assets                     | 709,786         | 39,371         | 2,347,259                        | 3,096,416    |
| Net capital expenditures                | -               | -              | -                                | -            |
| <b>Six months ended June 30, 2010</b>   |                 |                |                                  |              |
| Total sales                             | \$ 718,444      | \$ 309,208     | \$ -                             | \$ 1,027,652 |
| Total other income                      | 7,144           | -              | -                                | 7,144        |
| Earnings (loss) before tax              | 24,598          | 143,144        | (147,074)                        | 20,668       |
| Depreciation/amortization               | 14,722          | -              | 1,234                            | 15,956       |
| Identifiable assets                     | 630,039         | 9,642          | 2,460,097                        | 3,099,778    |
| Net capital expenditures                | 1,051           | -              | -                                | 1,051        |
| <b>Six Months ended June 30, 2009</b>   |                 |                |                                  |              |
| Total sales                             | \$ 749,170      | \$ 222,858     | \$ -                             | \$ 972,028   |

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|                            |         |        |           |           |
|----------------------------|---------|--------|-----------|-----------|
| Total other income         | 16,569  | 415    | -         | 16,984    |
| Earnings (loss) before tax | 97,895  | 84,316 | (142,594) | 39,617    |
| Depreciation/amortization  | 18,797  | -      | 1,274     | 20,071    |
| Identifiable assets        | 709,786 | 39,371 | 2,347,259 | 3,096,416 |
| Net capital expenditures   | -       | -      | -         | -         |

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATION

*Management's discussion and analysis is intended to be read in conjunction with the Company's unaudited financial statements and the integral notes thereto for the quarter ending June 30, 2010. The following statements may be forward looking in nature and actual results may differ materially.*

**A. Results of Operations**

**REVENUES:**

Total revenues from the sale of the Company's ESTeem wireless modem products and services decreased to \$472,623 for the second quarter of 2010, compared to \$519,899 for the second quarter of 2009. Gross revenues decreased to \$476,220 for the quarter ended June 30, 2010, from \$526,030 for the same quarter of 2009. Year to date sales increased to \$1,027,652 as of June 30, 2010 as compared to \$972,028 as of June 30, 2009. Year to date gross revenues increased to \$1,034,796 as of June 30, 2010 compared to \$989,013 as of June 30, 2009. Management believes the decrease in quarterly sales revenues is due to reduced orders received for domestic industrial automation projects during second quarter of 2010. We believe the year to date increase in sales revenues is due primarily to increased orders for foreign projects when compared with the same period of 2009. Management believes that the tenuous worldwide economic recovery makes sales revenues during 2010 difficult to predict and prone to potential fluctuation.

The Company's revenues have historically fluctuated from quarter to quarter due to timing factors such as customer order placement and product shipments to customers, as well as customer buying trends, and changes in the general economic environment. The procurement process regarding plant and project automation, or project development, which usually surrounds the decision to purchase ESTeem products, can be lengthy. This procurement process may involve bid activities unrelated to the ESTeem products, such as additional systems and subcontract work, as well as capital budget considerations on the part of the customer. Because of the complexity of this procurement process, forecasts in regard to the Company's revenues become difficult to predict.

A percentage breakdown of EST's Domestic and Export Sales, for the second quarter of 2010 and 2009 are as follows:

|                | For the second quarter of |      |
|----------------|---------------------------|------|
|                | 2010                      | 2009 |
| Domestic Sales | 75%                       | 77%  |
| Export Sales   | 25%                       | 23%  |

## OPERATING SEGMENTS

Segment information is prepared on the same basis that the Company's Management reviews financial information for operational decision-making purposes. The Company's operating segment information is contained in Financial Statements, Notes to Financial Statements, Note 6 Segment Reporting .

### Domestic Revenues

During the quarter ended June 30, 2010, the Company's domestic operations represented 75% of the Company's total sales revenues. Domestic operations sell ESTeem modem products, accessories and service primarily through domestic resellers, as well as directly to end users of the Company's products. Domestic sales revenues decreased to \$352,173 for the quarter ended June 30, 2010, compared to \$400,795 for the quarter ended June 30, 2009. We believe the decrease in quarterly sales revenues is due to reduced orders received for domestic industrial automation projects during the second quarter of 2010. Management believes that the tenuous economic recovery in the United States makes sales revenues during 2010 difficult to predict and prone to potential fluctuation. During the quarter ended June 30, 2010 no sales to a single customer comprised 10% or more of the Company's product sales.

Domestic segment operating income was \$2,953 for the quarter ended June 30, 2010 as compared with a segment operating income of \$60,524 for the same quarter of 2009, due to increased operating expenses and reduced sales revenues for the segment during the second quarter of 2010.

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For the six-month period ended June 30, 2010, the Company's domestic operations represented 70% of the Company's total sales revenues. Year to date domestic sales revenues decreased to \$718,444 as of June 30, 2010 compared to \$749,170 for the same period of 2009. We believe the decrease in year to date sales revenues is due to reduced orders received for domestic industrial automation projects during the first half of 2010. Management believes that the tenuous economic recovery in the United States makes sales revenues during 2010 difficult to predict and prone to potential fluctuation. The Company's year to date domestic sales were augmented by sales of the Company's products for mobile data computer systems (MDCS) to public entities, which accounted for 9% of the Company's domestic sales during the first six months of 2010. We believe that MDCS sales are difficult to predict and cannot be assured due to public safety entity purchases being linked to uncertain government funding.

Year to date domestic segment operating income was \$24,598 for the period ended June 30, 2010 as compared with a segment operating income of \$97,895 for the same period of 2009, due to increased operating expenses and reduced sales revenues for the segment during the first half of 2010.

### Foreign Revenues

The Company's foreign operating segment represented 25% of the Company's total net revenues for the quarter ended June 30, 2010. The foreign operating segment is based wholly in the United States and maintains no assets outside of the United States. The foreign operating segment sells ESTeem modem products, accessories and service primarily through foreign resellers, as well as directly to end customers of the Company's products located outside the United States.

During the quarter ended June 30, 2010, the Company had \$120,450 in foreign export sales, amounting to 25% of total net revenues of the Company for the quarter, compared with foreign export sales of \$119,104 for the same quarter of 2009. We believe the increase in foreign sales revenues is due to orders received for communication backbone and industrial automation projects using the Company's products in the United Arab Emirates, Canada, Jamaica and France. Management believes that the tenuous economic recovery in the United States makes sales revenues during 2010 difficult to predict and prone to potential fluctuation. No foreign sales to a single customer comprised 10% or more of the Company's product sales for the quarter ended June 30, 2010. Products purchased by foreign customers were used primarily in communication backbone and industrial automation applications. We believe the majority of foreign export sales are the results of the Company's Latin American sales staff, EST foreign reseller activity, and the Company's internet website presence.

Operating income for the foreign segment was \$41,646 for the quarter ended June 30, 2010 as compared with a net operating income of \$42,947 for the same period of 2009, due to slightly increased operating expenses for the segment during the second quarter of 2010.

For the six-month period ended June 30, 2010, the Company had \$309,208 in foreign export sales, amounting to 30% of total sales revenues of the Company for the period, compared with foreign export sales of \$222,858 for the same

period of 2009. We believe the increase in foreign sales revenues is due to increased orders for industrial automation and communication backbone application in the United Arab Emirates, Canada, Latin America, Jamaica and France. Management believes that the tenuous economic recovery in the United States makes sales revenues during 2010 difficult to predict and prone to potential fluctuation.

Year to date foreign segment operating income was \$143,144 for the period ended June 30, 2010 as compared with a segment operating income of \$84,316 for the same period of 2009, due to increased sales revenues for the segment during the first half of 2010.

#### Unallocated Corporate

Unallocated corporate expenses relate to functions, such as accounting, corporate management and administration that support but are not attributable to the Company's domestic or foreign operating segments, including salaries, wages and other expenses related to the performance of these support functions. Unallocated corporate expenses increased during the quarter ended June 30, 2010 to \$64,003 as compared with \$59,191 for the same quarter of 2009, and represented expense to total net revenues percentages of 13% and 11% for the first quarters of 2010 and 2009, respectively.

Year to date unallocated corporate expenses for the period ended June 30, 2010 were \$147,074 as compared with \$142,594 for the same period of 2009, due to increased professional services and department related supplies, and represented expense to total net revenues percentages of 14% for the first six months of 2010 and 2009, respectively.

**BACKLOG:**

The Corporation had minimal order backlog as of June 30, 2010. The Company's customers generally place orders on an "as needed basis". Shipment for most of the Company's products is generally made within 1 to 15 working days after receipt of customer orders, with the exception of ongoing, scheduled projects, and custom designed equipment.

**COST OF SALES:**

Cost of sales percentage for the second quarter of 2010 and 2009 was 42% and 41%, respectively. The cost of sales increase for the second quarter of 2010 is the result of the product mix for items sold during the quarter having a less favorable profit margin when compared with the same period of 2009.

**OPERATING EXPENSES:**

Operating expenses for the second quarter of 2010 increased \$30,134 from the second quarter of 2009. The following is an outline of operating expenses:

| For the quarter ended:   | June 30, 2010 | June 30, 2009 | Increase (Decrease) |
|--------------------------|---------------|---------------|---------------------|
| Finance/Administration   | \$ 64,003     | \$ 59,191     | \$ 4,812            |
| Research/Development     | 86,285        | 67,189        | 19,096              |
| Marketing                | 123,839       | 116,607       | 7,232               |
| Customer Service         | 24,052        | 25,058        | ( 1,006)            |
| Total Operating Expenses | \$ 298,179    | \$ 268,045    | \$ 30,134           |

**FINANCE AND ADMINISTRATION:**

During the second quarter of 2010, Finance and Administration expenses increased \$4,812 from the same quarter of 2009 due to increased professional services and department related supplies.

**RESEARCH AND DEVELOPMENT:**

Research and Development expenses increased \$19,096 during the second quarter of 2010, when compared with the same period in 2009. The increase is due to increased subcontracted engineering expertise when compared with the same quarter of 2009.

**MARKETING:**

During the second quarter of 2010, marketing expenses increased \$7,232 from the same period in 2009, due to increased advertising and travel expenses.

**CUSTOMER SERVICE:**

Customer service expenses decreased minimally during the second quarter of 2010 when compared with the same quarter of 2009.

**INTEREST AND DIVIDEND INCOME:**

The Corporation earned \$3,597 in interest and dividend income during the quarter ended June 30, 2010. Sources of this income were money market accounts and certificates of deposit.

**NET INCOME (LOSS):**

The Company had a net loss of \$15,904 for the second quarter of 2010, compared to net income of \$37,680 for the same quarter of 2009. For the six-month period ended June 30, 2010, the Company recorded a net income of \$19,468 compared with a net income of \$36,117 for the same period of 2009. The reduction in the Company's profitability is the result of reduced sales revenues and increased operating expenses during the second quarter of 2010.



## **B. Financial Condition, Liquidity and Capital Resources**

The Corporation's current asset to current liabilities ratio at June 30, 2010 was 29.5:1 compared to 33:1 at December 31, 2009. For the quarter ending June 30, 2010, the Company had cash and cash equivalents of \$857,281, compared to cash and cash equivalent holdings of \$919,608 at December 31, 2009. The Company had certificates of deposit investments in the amount of \$1,467,000 as of June 30, 2010 as compared to \$1,372,000 as of December 31, 2009.

Accounts receivable increased to \$163,020 as of June 30, 2010, from December 31, 2009 levels of \$121,993, due to differences in the sales and collection cycle during the second quarter of 2010 when compared with year-end 2009.

Inventory decreased to \$476,661 at June 30, 2010, from December 31, 2009 levels of \$503,326, due to decreased material purchases by the Company to more closely match reduced sales revenues. The Company's fixed assets, net of depreciation, decreased to \$55,675 as of June 30, 2010, from December 31, 2009 levels of \$70,580, due to depreciation of \$15,956.

Since January 1, 2005, the Company has contracted with Netsuite Inc. to provide the Company's customer relationship management and accounting software and related network infrastructure services. The prepaid Netsuite Inc. services as of June 30, 2010 are reflected in prepaid expenses on the Company's balance sheet in the amount of \$31,617.

As of June 30, 2010, the Company's accounts payable balance was \$54,685 as compared with \$33,275 at December 31, 2009, and reflects amounts owed for inventory items, contracted services, and state tax liabilities. Accrued liabilities as of June 30, 2010 were \$46,664, compared with \$56,725 at December 31, 2009, and reflect items such as accrued vacation benefits. The Company's prepaid federal income tax asset of \$20,896 at December 31, 2009 was eliminated by the Company receiving a tax refund from the Internal Revenue Service.

In Management's opinion, the Company's cash and cash equivalent reserves, and working capital at June 30, 2010 is sufficient to satisfy requirements for operations, capital expenditures, and other expenditures as may arise during the remainder of 2010.

***FORWARD LOOKING STATEMENTS: The above discussion may contain forward looking statements that involve a number of risks and uncertainties. In addition to the factors discussed above, among other factors that could cause actual results to differ materially are the following: competitive factors such as rival wireless architectures and price pressures; availability of third party component products at reasonable prices; inventory risks due to shifts in market demand and/or price erosion of purchased components; change in product mix, and risk factors that are listed in the Company's reports and registration statements filed with the Securities and Exchange Commission.***

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

There is no established market for trading the Common Stock of the Company. The market for the Company's common stock is limited, and as such shareholders may have difficulty reselling their shares when desired or at attractive market prices. The Common Stock is not regularly quoted in the automated quotation system of a registered securities system or association. The Common Stock of the Company is traded on the over-the-counter market maintained by the Financial Industry Regulatory Authority ( FINRA ) and is listed on the OTC electronic bulletin board under the symbol of "ELST". The Company's common stock has continued to trade in low volumes and at low prices. Some investors view low-priced stocks as unduly speculative and therefore not appropriate candidates for investment. Many institutional investors have internal policies prohibiting the purchase or maintenance of positions in low-priced stocks.

**Item 4. Controls and Procedures.**

As a small, non-accelerated filer company, information required by Item 307 of Regulation S-K is not applicable to Electronic Systems Technology, Inc.

**Item 4T. Controls and Procedures.**

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. The Company's internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements; providing reasonable assurance that receipts and expenditures of Company assets are made in accordance with

management authorization; and providing reasonable assurance that unauthorized acquisition, use or disposition of Company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

An evaluation has been performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and the operation of our "disclosure controls and procedures" (as such term is defined in Rules 13a-15(e) under the Securities Exchange Act of 1934) as of June 30, 2010. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have determined that there was a material weakness affecting our internal control over financial reporting and, as a result of that weakness, our disclosure controls and procedures were not effective as of June 30, 2010.

The material weakness is as follows:

We did not maintain effective controls to ensure appropriate segregation of duties as the same employees were responsible for the initiating and recording of transactions, thereby creating segregation of duties weaknesses. Due to the (1) significance of segregation of duties to the preparation of reliable financial statements; (2) the significance of potential misstatement that could have resulted due to the deficient controls; and, (3) the absence of sufficient other mitigating controls; we determined that this control deficiency resulted in more than a remote likelihood that a material misstatement or lack of disclosure within the annual or interim financial statements will not be prevented or detected.

Management has evaluated and continues to evaluate, avenues for mitigating our internal controls weaknesses, but mitigating controls that are practical and cost effective have not been found based on the size and structure of our organization. Taking into account reduced revenues experienced during 2009, and the tenuous economic recovery in the United States, Management does not foresee implementing a cost effective method of mitigating our internal controls weaknesses in the near term. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks.

#### **Changes in internal control over financial reporting.**

Except as noted above, there have been no changes during the quarter ended June 30, 2010 in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, internal controls over financial reporting.



**PART II**  
**OTHER INFORMATION**

**Item 4. Removed and Reserved**

**Item 5. Other Information**

At the Company's Annual Stockholder Meeting on June 4, 2010, in Kennewick, Washington the following items were voted on by the stockholders with the following outcomes:

Item #1 Election of Director:

John L. Schooley  
Votes for: 3,002,649      Abstain: 149,130

Item #2 Ratification of Moe O Shaughnessy & Associates, P.S. as independent auditors and tax service provider for the Corporation for the fiscal year ending December 31, 2010.

Votes for: 4,147,327      Votes against: 23,531      Abstain: 3,680

The Company filed a Form 8-K dated February 19, 2010 regarding issuance of stock options pursuant to the Company's stock option award program, which is incorporated herein by reference.

**Item 6. Exhibits**

- 31.1 CEO Certification
- 31.2 CFO Certification

32.1 CEO Section 906 Certification

32.2 CFO Section 906 Certification

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

Date: August 10, 2010

/s/ T. L. KIRCHNER

Name: T.L. Kirchner

Title: Director/President

(Principal Executive Officer)

Date: August 10, 2010

/s/ JON CORREIO

Name: Jon Correio

Title: Director/Secretary/Treasurer

(Principal Financial Officer)

