

ELECTRONIC SYSTEMS TECHNOLOGY INC  
Form 10-Q  
August 12, 2009

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, 2009**

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**  
(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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of June 30, 2009, 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, 2009	June 30, 2008
Sales	\$ 972,028	\$ 1,061,047
Other Revenues	16,984	35,220
Gross Profit	576,158	588,074
Net Income (Loss) Before Taxes	\$ 39,617	\$ (158,917)
Net Income (Loss) After Taxes	36,117	(133,517)
Earnings (Loss) Per Share Before Taxes		
Basic	\$ 0.01	\$ (0.03)
Diluted	0.01	(0.03)
Earnings (Loss) Per Share After Taxes		
Basic	\$ 0.01	\$ (0.03)
Diluted	0.01	(0.03)
Weighted Average Shares Outstanding (Basic)		
Primary	5,158,667	5,157,156
Diluted	5,158,667	5,199,551
Total Assets	\$ 3,096,416	\$ 3,251,230
Long-Term Debt and Capital Lease Obligations	\$ 0	\$ 0

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Shareholders' Equity	\$	2,969,419	\$	2,950,476
Shareholders' Equity Per Share	\$	0.58	\$	0.57
Working Capital	\$	2,877,428	\$	2,817,271
Current Ratio		30:1		12:1
Equity To Total Assets		96%		91%

(See "Notes to Financial Statements")

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

(as prepared by Management)

(Unaudited)

	June 30, 2009	Dec. 31, 2008
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 862,329	\$ 512,800
Short Term Certificates of Deposit Investments	1,292,000	1,432,000
Accounts Receivable, net of allowance for uncollectibles	197,064	195,429
Inventory	552,093	639,779
Accrued Interest	5,682	13,521
Prepaid Federal Income Taxes	25,600	37,600
Federal Income Taxes Receivable	--	63,842
Prepaid Expenses	41,657	26,742
Total Current Assets	2,976,425	2,921,713
PROPERTY & EQUIPMENT net of depreciation	90,651	110,722
OTHER ASSETS	340	340
DEFERRED INCOME TAX BENEFIT	29,000	27,100
<b>TOTAL ASSETS</b>	<b>\$ 3,096,416</b>	<b>\$ 3,059,875</b>
<b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts Payable	\$ 50,277	\$ 50,013
Accrued Liabilities	48,720	43,535
Total Current Liabilities	98,997	93,548
DEFERRED INCOME TAX LIABILITY	28,000	34,600
<b>STOCKHOLDERS' EQUITY</b>		
Common Stock, \$.001 Par Value		

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50,000,000 Shares Authorized

5,158,667 Shares Issued and Outstanding for June 30, 2009 and

June 30, 2008	5,159	5,159
Additional Paid-in Capital	991,875	990,300
Retained Earnings	1,972,385	1,936,268
	2,969,419	2,931,727
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 3,096,416	\$ 3,059,875

(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, 2009	June 30, 2008	June 30, 2009	June 30, 2008
SALES	\$ 519,899	\$ 480,910	\$ 972,028	\$ 1,061,047
COST OF SALES	213,704	219,967	395,870	472,973
Gross Profit	306,194	260,943	576,158	588,074
<b>OPERATING EXPENSES</b>				
Finance/Administration	59,191	70,075	142,594	171,839
Research & Development	67,189	132,171	135,463	260,008
Marketing	116,607	149,912	225,793	275,959
Customer Service	25,058	37,586	49,676	74,405
Total Operating Expenses	268,045	389,744	553,526	782,211
OPERATING INCOME (LOSS)	38,149	(128,801)	22,632	(194,137)
Other Income (expenses)				
Interest/Investment Income	6,131	15,999	16,985	34,695
Uncollectible amount recovered	--	525	--	525
Net Other Income (Expense)	6,131	16,524	16,985	35,220
NET INCOME (LOSS) BEFORE TAX	44,280	(112,277)	39,617	(158,917)
Provision For Income Tax	(6,600)	15,000	(3,500)	25,400
NET INCOME (LOSS)	\$ 37,680	\$ (97,277)	\$ 36,117	\$ (133,517)
Basic Earnings (Loss) Per Share				
Before Tax	\$ 0.01	\$ (0.02)	\$ 0.01	\$ (0.03)
Basic Earnings (Loss) Per Share				
After Tax	\$ 0.01	\$ (0.02)	\$ 0.01	\$ (0.03)
Diluted Earnings (Loss) Per Share				



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Before Tax	\$	0.01	\$	(0.02)	\$	0.01	\$	(0.03)
Diluted Earnings (Loss) Per Share								
After Tax	\$	0.01	\$	(0.02)	\$	0.01	\$	(0.03)

(See "Notes to Financial Statements")

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

(as prepared by Management)

(Unaudited)

	Six Months Ended	
	June 30, 2009	June 30, 2008
<b>CASH FLOWS PROVIDED (USED) IN OPERATING ACTIVITIES:</b>		
Net Income (Loss)	\$ 36,117	\$ (133,517)
Noncash items included in income:		
Depreciation	20,071	24,727
Prepaid Federal Income Taxes	12,000	(48,300)
Accrued Interest	7,839	7,310
Deferred Income Tax	(8,500)	(14,700)
Share Based Compensation	1,575	3,920
<b>DECREASE (INCREASE) IN CURRENT ASSETS:</b>		
Accounts Receivable Net	(1,635)	112,781
Inventory	87,686	(151,727)
Federal Income Taxes Receivable	63,842	--
Prepaid Expenses	(14,915)	(27,547)
<b>INCREASE (DECREASE) IN CURRENT LIABILITIES:</b>		
Accounts Payable and Accrued Expenses	5,449	(78,881)
Refundable Deposits	--	(4,394)
Accrued Federal Income Taxes	--	(12,304)
	209,529	(322,632)
<b>CASH FLOWS PROVIDED (USED) IN INVESTING ACTIVITIES:</b>		
Certificates of Deposit Redeemed (Purchased)	140,000	190,000
Additions To Property And Equipment	--	(10,853)
	140,000	179,147
<b>CASH FLOWS PROVIDED (USED) IN FINANCING ACTIVITIES:</b>		
Stock Option Exercise	--	3,900

NET INCREASE (DECREASE) IN CASH AND

CASH EQUIVALENTS	349,529	(139,585)
Cash And Cash Equivalents At Beginning Of Period	512,800	1,479,985
Cash And Cash Equivalents At Ending of Period	\$ 862,329	\$ 1,340,400

SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION:

Cash Paid Year To Date:

Interest	\$ 0	\$ 0
Federal Income Taxes	\$ 0	\$ 49,904

Cash allocated for Cash Distribution	\$ 0	\$ 103,173
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Cash And Cash Equivalents:

Cash	\$ 25,079	\$ 23,815
Money Market Accounts	837,250	1,316,585
	\$ 862,329	\$ 1,340,400

(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, 2009 and June 30, 2008. 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, 2008 as filed with Securities and Exchange Commission.

The results of operations for the three and six months ended June 30, 2009 and June 30, 2008, 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
	2009	2008
Parts	\$ 223,112	\$ 312,540
Work in progress	64,073	4
Finished goods	264,908	327,235
	\$ 552,093	\$ 639,779

**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 5,157,156 for the six months ended June 30, 2009 and 2008, respectively. The primary weighted average number of common shares outstanding for the three month period ending June 30, 2009 and 2008 was 5,158,667 and 5,173,958, respectively.

	For the three months ended June 30, 2009		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
<b>Basic EPS</b>			
Income available to common stockholders	\$37,680	5,158,667	\$0.01
<b>Diluted EPS</b>			
Income available to common stockholders + assumed conversions	\$37,680	5,158,667	\$0.01

**NOTE 4 - STOCK OPTIONS**

Effective January 1, 2006, the Company adopted the provisions of Financial Accounting Standards Board (FASB) Statement No. 123R, "Share-Based Payment", (FAS 123R) for its share-based compensation plan. The Company previously accounted for these plans under the recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees", (APB 25) and related interpretations and disclosure requirements established by FAS 123, "Accounting for Stock-Based Compensation". The Company adopted FAS 123R using the modified prospective method and, accordingly, results for prior periods have not been restated.

As of June 30, 2009, 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, 2009, additional 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, 2009 totaled 195,000 shares under option and have an exercise price of \$0.31 per share.

The options granted on February 19, 2009 may be exercised any time during the period from February 19, 2009 through February 19, 2012. The Company's Form 8-K dated February 19, 2009, 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:

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

The Company uses historical data to estimate option exercise rates. The option exercise rate for option grants in 2009 through 2005 was 9%.

A summary of option activity during the six months ended June 30, 2009 is as follows:

	Number Outstanding	Weighted-Average Exercise Price Per Share
Outstanding at January 1, 2009	570,000	\$0.72
Granted	195,000	0.31
Exercised	--	--
Canceled	(200,000)	0.68
Outstanding at June 30, 2009	565,000	0.60

For the second quarter of 2009, compensation expense charged against income for stock options was \$788 (\$520 after tax). No non-vested share-based compensation arrangements existed as of June 30, 2009.

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

For the six-month period ended June 30, 2009, services in the amount of \$27,132 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, 2009, Domestic customers represented approximately 77% of total net revenues. Foreign customers represented approximately 23% 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 2009 consist primarily of revenues from Mexico, Peru and Canada.

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 2009 and 2008 is as follows:

	<u>Domestic</u>	<u>Foreign</u>	<u>Unallocated Corporate</u>	<u>Total</u>
<b><u>Three months ended June 30, 2009</u></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	-	-	-	-

**Three months ended June 30, 2008**

Total sales	\$ 315,484	\$ 165,426	\$ -	\$ 480,910
Total other income	16,524	-	-	16,524
Earnings (loss) before tax	(83,517)	41,315	(70,075)	(112,277)
Depreciation/amortization	11,876	-	687	12,563
Identifiable assets	871,262	46,949	2,333,020	3,251,231
Net capital expenditures	7,356	-	-	7,356

**Six months ended June 30, 2009**

Total sales	\$ 749,170	\$ 222,858	\$ -	\$ 972,028
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	-	-	-	-

**Six Months ended June 30, 2008**



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Total sales	\$ 733,624	\$ 327,423	\$ -	\$ 1,061,047
Total other income	35,220	-	-	35,220
Earnings (loss) before tax	(77,059)	89,981	(171,839)	(158,917)
Depreciation/amortization	23,387	-	1,340	24,727
Identifiable assets	871,262	46,949	2,333,020	3,251,231
Net capital expenditures	7,356	-	3,497	10,853

**NOTE 7 - CASH DISTRIBUTION**

On June 6, 2008, the Company declared a one-time, non-cumulative, cash distribution to shareholders of record as of June 23, 2008, of \$0.02 per share of common stock, with a payable date of July 18, 2008. The payment of the cash distribution was completed by July 18, 2008. For the quarter ended June 30, 2008, the Company recognized a current liability in the amount of \$103,173, reflecting the total dollar value of the cash distribution. The Company did not declare a cash distribution for 2009.

**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, 2009. 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 increased to \$519,899 for the second quarter of 2009, compared to \$480,910 for the second quarter of 2008. Gross revenues increased to \$526,030 for the quarter ended June 30, 2009, from \$497,434 for the same quarter of 2008. Year to date sales decreased to \$972,028 as of June 30, 2009 as compared to \$1,061,047 as of June 30, 2008. Year to date gross revenues decreased to \$989,013 as of June 30, 2009 compared to \$1,096,267 as of June 30, 2008. We believe the increase in quarterly sales revenues is due to orders received for domestic industrial automation projects late in the second quarter of 2009. We feel that this quarterly revenue increase is temporary, and that the year to date decrease in sales revenues is due to the continued widespread economic downturn in the United States and worldwide, that has lead to delays or cancellations in funding of industrial automation projects using the Company's products. We believe that the continued economic downturn may continue to negatively affect the Company's sales revenues during the remainder of 2009.

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 2009 and 2008 are as follows:

	For the second quarter of 2009 2008	
Domestic Sales	77%	66%
Export Sales	23%	34%

## 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, 2009, the Company's domestic operations represented 77% 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 increased to \$400,795 for the quarter ended June 30, 2009, compared to \$315,484 for the quarter ended June 30, 2008. We believe the increase in quarterly sales revenues is due to orders received for domestic industrial automation projects late in the second quarter of 2009. We feel that the quarterly revenue increase is temporary and that the continued economic downturn may continue to negatively affect the Company's domestic sales revenue during the remainder of 2009.

The Company's domestic sales were augmented by sales of the Company's products for MDCS projects to public entities, which accounted for 5% of the Company's domestic sales during the second quarter of 2009. Management believes MDCS sales were weaker than expected during the first quarter of 2009 due to reduced funding for projects involving the Company's products and the extended procurement cycle for public safety entities. 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. During the quarter ended June 30, 2009 no sales to a single customer comprised 10% or more of the Company's domestic product sales.

Domestic segment operating income was \$60,524 for the quarter ended June 30, 2009 as compared with a segment operating loss of \$83,517 for the same quarter of 2008, due to decreased operating expenses for the segment during the second quarter of 2009.

For the six-month period ended June 30, 2009, the Company's domestic operations represented 77% of the Company's total sales revenues. Year to date domestic sales revenues increased to \$749,170 as of June 30, 2009 compared to \$733,624 for the same period of 2008. We believe the increase in quarterly sales revenues is due to orders received for domestic industrial automation projects late in the second quarter of 2009. We feel that the quarterly revenue increase is temporary and that the continued economic downturn may continue to negatively affect the Company's domestic sales revenue during the remainder of 2009. The Company's year to date domestic sales were augmented by sales of the Company's products for MDCS to public entities, which accounted for 5% of the Company's domestic sales during the first six months of 2009.

Year to date domestic segment operating income was \$97,895 for the period ended June 30, 2009 as compared with a segment operating loss of \$77,059 for the same period of 2008, due to decreased operating expenses for the segment during the first half of 2009.

#### Foreign Revenues

The Company's foreign operating segment represented 23% of the Company's total net revenues for the quarter ended June 30, 2009. 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, 2009, the Company had \$119,104 in foreign export sales, amounting to 23% of total net revenues of the Company for the quarter, compared with foreign export sales of \$165,426 for the same quarter of 2008. We believe the decrease in foreign sales revenues is due to the continued widespread worldwide economic downturn that has led to delays or cancellations in funding of industrial automation projects using the Company's products. We believe that the continued economic downturn may continue to negatively affect the Company's foreign sales revenue during the remainder of 2009. No foreign sales to a single customer comprised 10% or more of the Company's product sales for the quarter ended June 30, 2009. Products purchased by foreign customers were used primarily in 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 increased to \$42,947 for the quarter ended June 30, 2009 as compared with a net operating income of \$41,315 for the same period of 2008, due to decreased operating expenses for the segment during the second quarter of 2009.

For the six-month period ended June 30, 2009, the Company had \$222,858 in foreign export sales, amounting to 23% of total sales revenues of the Company for the period, compared with foreign export sales of \$327,423 for the same period of 2008. We believe the decrease in foreign sales revenues is due to the continued widespread worldwide economic downturn that has led to delays or cancellations in funding of industrial automation projects using the Company's products. We believe that the continued economic downturn may continue to negatively affect the Company's foreign sales revenue during the remainder of 2009. Products purchased by foreign customers were used primarily in industrial automation applications.

Year to date foreign segment operating income decreased to \$84,316 for the period ended June 30, 2009 as compared with a segment operating income of \$89,981 for the same period of 2008, due to decreased sales revenues for the segment during the first half of 2009.

#### 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 decreased during the quarter ended June 30, 2009 to \$59,191 as compared with \$70,075 for the same quarter of 2008, and represented expense to total net revenues percentages of 11% and 14% for the first quarters of 2009 and 2008, respectively.

Year to date unallocated corporate expenses decreased for the period ended June 30, 2009 to \$142,594 as compared with \$171,839 for the same period of 2008, due to decreased professional services, general equipment maintenance and department related wages, and represented expense to total net revenues percentages of 14% and 16% for the first six months of 2009 and 2008, respectively.

**BACKLOG:**

The Corporation had an order backlog of \$21,000 as of June 30, 2009. 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 2009 and 2008 was 41% and 46%, respectively. The cost of sales decrease for the second quarter of 2009 is the result the product mix for items sold during the quarter having a more favorable profit margin when compared with the same period of 2008.

**OPERATING EXPENSES:**

Operating expenses for the second quarter of 2009 decreased \$121,699 from the second quarter of 2008. The following is an outline of operating expenses:

For the quarter ended:	June 30, 2009	June 30, 2008	Increase (Decrease)
Finance/Administration	\$ 59,191	\$ 70,075	\$ ( 10,884)
Research/Development	67,189	132,171	( 64,982)
Marketing	116,607	149,912	( 33,305)
Customer Service	25,058	37,586	( 12,528)
Total Operating Expenses	\$ 268,045	\$ 389,744	\$ ( 121,699)

**FINANCE AND ADMINISTRATION:**

During the second quarter of 2009, Finance and Administration expenses decreased to \$59,191 from the same quarter of 2008 due to decreased wages and professional service expenses during the second quarter of 2009.

**RESEARCH AND DEVELOPMENT:**

Research and Development expenses decreased \$64,982 during the second quarter of 2009, when compared with the same period in 2008. The decrease is due to reduced subcontracted engineering expertise, research and development related supplies and wages when compared with the same quarter of 2008.

**MARKETING:**

During the second quarter of 2009, marketing expenses decreased \$33,305 from the same period in 2008, due to decreased wages, advertising and trade show expenses.

**CUSTOMER SERVICE:**

Customer service expenses decreased \$12,528 during the second quarter of 2009 due to a decreased amount of wages and travel expenses when compared with the same quarter of 2008.

**INTEREST AND DIVIDEND INCOME:**

The Corporation earned \$6,131 in interest and dividend income during the quarter ended June 30, 2009. Sources of this income were money market accounts and certificates of deposit.

**NET INCOME (LOSS):**

The Company had net income of \$37,680 for the second quarter of 2009, compared to a net loss of \$97,277 for the same quarter of 2008. For the six-month period ended June 30, 2009, the Company recorded a net income of \$36,117 compared with a net loss of \$133,517 for the same period of 2008. The improvement in the Company's profitability is due to decreased operating expenses resulting from Management's aggressive cost reduction and control during 2009.





## B. Financial Condition, Liquidity and Capital Resources

The Corporation's current asset to current liabilities ratio at June 30, 2009 was 30:1 compared to 31.2:1 at December 31, 2008. For the quarter ending June 30, 2009, the Company had cash and cash equivalents of \$862,329, compared to cash and cash equivalent holdings of \$512,800 at December 31, 2008. The Company had certificates of deposit investments in the amount of \$1,292,000 as of June 30, 2009 as compared to \$1,432,000 as of December 31, 2008.

Accounts receivable increased slightly to \$197,064 as of June 30, 2009, from December 31, 2008 levels of \$195,429, due to strong sales late in the second quarter of 2009. Inventory decreased to \$552,093 at June 30, 2009, from December 31, 2008 levels of \$639,779, due to decreased material purchases by the Company that more closely matched reduced sales revenues during the first six months of 2009. The Company's fixed assets, net of depreciation, decreased to \$90,651 as of June 30, 2009, from December 31, 2008 levels of \$110,722, due to depreciation of \$20,071.

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, 2009 are reflected in prepaid expenses on the Company's balance sheet in the amount of \$29,964.

As of June 30, 2009, the Company's accounts payable balance was \$50,277 as compared with \$50,013 at December 31, 2008, and reflects amounts owed for inventory items, contracted services, and state tax liabilities. Accrued liabilities as of June 30, 2009 were \$48,720, compared with \$43,535 at December 31, 2008, and reflect items such as accrued vacation benefits. The Company's prepaid federal income tax asset decreased to \$25,600 at June 30, 2009 from \$37,600 at December 31, 2008, as a result of improved Company profitability during the first six months of 2009. The Company's Federal Income Taxes Receivable asset of \$63,842 at December 31, 2008 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, 2009 is sufficient to satisfy requirements for operations, capital expenditures, and other expenditures as may arise during the remainder of 2009.

***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, 2009. 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, 2009.

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 our net loss for 2008, reduced revenues experienced to date in 2009, and the continued uncertainty posed by the current United States and worldwide economic downturn, 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, 2009 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. Submission of Matters to the Securities Holders**

At the Company's Annual Stockholder Meeting on June 5, 2009, in Kennewick, Washington the following items were voted on by the stockholders with the following outcomes:

Item #1 Election of Directors:

Melvin H. Brown

Votes for: 4,337,213 Against: 102,275 Abstain: 2,400

Jon Correio

Votes for: 4,318,281 Against: 122,707 Abstain: 900

Robert Southworth

Votes for: 4,390,781 Against: 50,207 Abstain: 900

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, 2009.

Votes for: 4,365,460 Votes against: 20,938 Abstain: 55,490

**Item 5. Other Information**

The Company filed a Form 8-K dated February 19, 2009 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.

/s/ T. L. KIRCHNER

Date: August 12, 2009

Name: T.L. Kirchner

Title: Director/President

(Principal Executive Officer)

/s/ JON CORREIO

Date: August 12, 2009

Name: Jon Correio

Title: Director/Secretary/Treasurer

(Principal Financial Officer)

