

ELECTRONIC SYSTEMS TECHNOLOGY INC  
Form 10QSB  
August 09, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON D.C. 20549

**FORM 10-QSB**

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended June 30, 2006

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

|                         |           |
|-------------------------|-----------|
| Commission File Number: | 000-27793 |
|-------------------------|-----------|

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

(A Washington Corporation)

|                                    |            |
|------------------------------------|------------|
| I.R.S. Employer Identification no. | 91-1238077 |
|------------------------------------|------------|

415 N. Quay St., Building B1  
Kennewick WA 99336  
(509) 735-9092

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of June 30, 2006: 5,153,667 shares of common \$0.001 par value.

Transitional Small Business Disclosure Format (check one): Yes  No .

## PART I - FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS.

## ELECTRONIC SYSTEMS TECHNOLOGY, INC.

(as prepared by Management)

(Unaudited)

| Six Months Ended                            | <u>June 30, 2006</u> | <u>June 30, 2005</u> |
|---|----------------------|----------------------|
| Sales                                       | \$ 1,128,803         | \$ 1,130,184         |
| Other Revenues                              | 22,935               | 16,135               |
| Gross Profit                                | 632,285              | 581,801              |
|   |                      |                      |
| Net Income (Loss) Before Taxes              | 6,640                | 19,963               |
| Net Income (Loss) After Taxes               | 5,305                | 5,247                |
|   |                      |                      |
| Earnings (Loss) Per Share Before Taxes      |                      |                      |
| Basic                                       | \$ 0.00              | \$ 0.00              |
| Diluted                                     | 0.00                 | 0.00                 |
|   |                      |                      |
| Earnings (Loss) Per Share After Taxes       |                      |                      |
| Basic                                       | \$ 0.00              | \$ 0.00              |
| Diluted                                     | 0.00                 | 0.00                 |
|   |                      |                      |
| Weighted Average Shares Outstanding (Basic) |                      |                      |
| Primary                                     | 5,152,258            | 5,148,667            |
| Diluted                                     | 5,178,098            | 5,236,410            |
|   |                      |                      |

|  |              |              |
|--|--------------|--------------|
| Total Assets                                 | \$ 2,995,813 | \$ 2,903,995 |
|  |              |              |
| Long-Term Debt and Capital Lease Obligations | \$ 0         | \$ 0         |
|  |              |              |
| Shareholders' Equity                         | \$ 2,729,602 | \$ 2,656,484 |
|  |              |              |
| Shareholders' Equity Per Share               | \$ 0.53      | \$ 0.52      |
|  |              |              |
| Working Capital                              | \$ 2,562,555 | \$ 2,448,905 |
|  |              |              |
| Current Ratio                                | 12.9:1       | 15.0:1       |
|  |              |              |
| Equity To Total Assets                       | 91%          | 91%          |

(See "Notes to Financial Statements")

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ELECTRONIC SYSTEMS TECHNOLOGY, INC.  
BALANCE SHEETS

(as prepared by Management)  
(Unaudited)

|  | <u>June 30, 2006</u> | <u>Dec. 31, 2005</u> |
|--|----------------------|----------------------|
| ASSETS   |                      |                      |
| CURRENT ASSETS                                 |                      |                      |
| Cash and Cash Equivalents                      | \$ 599,333           | \$ 651,265           |
| Short Term Certificates of Deposit Investments | 359,640              | 449,613              |
| Available for Sale Marketable Securities       | 1,038,224            | 921,029              |
|  |                      |                      |

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|  |                     |                     |
|--|---------------------|---------------------|
| Accounts Receivable, net of allowance for uncollectibles   | 159,113             | 222,982             |
| Inventory  | 575,412             | 485,257             |
| Accrued Interest   | 1,366               | 2,758               |
| Prepaid Expenses   | <u>44,978</u>       | <u>31,985</u>       |
| Total Current Assets   | <u>2,778,066</u>    | <u>2,764,889</u>    |
|  |                     |                     |
| PROPERTY & EQUIPMENT net of depreciation   | <u>178,443</u>      | <u>184,025</u>      |
|  |                     |                     |
| OTHER ASSETS   | <u>16,104</u>       | <u>25,067</u>       |
| DEFERRED INCOME TAX BENEFIT  | <u>23,200</u>       | <u>20,600</u>       |
| TOTAL ASSETS   | <u>\$ 2,995,813</u> | <u>\$ 2,994,581</u> |
|  |                     |                     |
| LIABILITIES & STOCKHOLDERS' EQUITY   |                     |                     |
|  |                     |                     |
| CURRENT LIABILITIES  |                     |                     |
| Accounts Payable   | 99,487              | 41,377              |
| Refundable Deposits  | 127                 | 72                  |
| Federal Income Taxes Payable   | 18,045              | 80,579              |
| Accrued Liabilities  | 46,315              | 54,109              |
| Distributions Payable  | <u>51,537</u>       | ---                 |
| Total Current Liabilities  | <u>215,511</u>      | <u>176,137</u>      |
|  |                     |                     |
| DEFERRED INCOME TAX LIABILITY  | 50,700              | 59,300              |
|  |                     |                     |
| STOCKHOLDERS' EQUITY   |                     |                     |
| Common Stock, \$.001 Par Value 50,000,000 Shares Authorized<br>5,153,667 Shares Issued And Outstanding | 5,154               | 5,149               |

|   |                     |                     |
|---|---------------------|---------------------|
| Additional Paid-in Capital                        | 972,173             | 966,184             |
| Retained Earnings                                 | <u>1,758,596</u>    | 1,804,828           |
| Accumulated other Comprehensive Gain (Loss)       | <u>(6,321)</u>      | <u>(17,017)</u>     |
|   | <u>2,729,602</u>    | <u>2,759,144</u>    |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b> |                     |                     |
|   | <b>\$ 2,995,813</b> | <b>\$ 2,994,581</b> |

(See "Notes to Financial Statements")

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

(as prepared by Management)  
(Unaudited)

|                           | Three Months Ended   |                      | Six Months Ended     |                      |
|---------------------------|----------------------|----------------------|----------------------|----------------------|
|                           | <u>June 30, 2006</u> | <u>June 30, 2005</u> | <u>June 30, 2006</u> | <u>June 30, 2005</u> |
| SALES                     | <u>\$ 640,970</u>    | <u>\$ 547,178</u>    | <u>\$ 1,128,803</u>  | <u>\$ 1,130,184</u>  |
| COST OF SALES             | <u>255,581</u>       | <u>281,467</u>       | <u>496,518</u>       | <u>548,383</u>       |
| Gross Profit              | <u>385,389</u>       | <u>265,711</u>       | <u>632,285</u>       | <u>581,801</u>       |
| <b>OPERATING EXPENSES</b> |                      |                      |                      |                      |
| Finance/Administration    | 66,959               | 62,696               | 144,477              | 138,699              |
| Research & Development    | 91,409               | 69,659               | 176,530              | 136,351              |
| Marketing                 | 142,662              | 129,733              | 250,848              | 234,766              |
| Customer Service          | <u>31,757</u>        | <u>26,966</u>        | <u>63,355</u>        | <u>56,229</u>        |
| Total Operating Expenses  | <u>332,787</u>       | <u>289,054</u>       | <u>635,210</u>       | <u>566,045</u>       |
| OPERATING INCOME (LOSS)   | <u>52,602</u>        | <u>(23,343)</u>      | <u>(2,925)</u>       | <u>15,756</u>        |

|  |                  |                     |                 |                 |
|--|------------------|---------------------|-----------------|-----------------|
| Other Income (expenses)                      |                  |                     |                 |                 |
| Interest/Investment Income                   | 11,504           | 9,811               | 19,778          | 16,134          |
| Uncollectible amount recovered               | --               | --                  | 3,157           | --              |
| Realized Loss on Marketable Securities       | --               | (1,500)             | (8,942)         | (7,140)         |
| Management Fee, Marketable Securities        | (2,320)          | (2,331)             | (4,428)         | (4,655)         |
| Loss on Asset Disposal                       | --               | --                  | --              | (132)           |
| Net Other Income (Expense)                   | <u>9,184</u>     | <u>5,980</u>        | <u>9,565</u>    | <u>4,207</u>    |
|  |                  |                     |                 |                 |
| NET INCOME (LOSS) BEFORE TAX                 | 61,786           | (17,363)            | 6,640           | 19,963          |
| Provision For Income Tax                     | <u>(26,482)</u>  | <u>2,645</u>        | <u>(1,335)</u>  | <u>(14,716)</u> |
| NET INCOME (LOSS)                            | <u>\$ 35,304</u> | <u>\$ ( 14,718)</u> | <u>\$ 5,305</u> | <u>\$ 5,247</u> |
|  |                  |                     |                 |                 |
| Basic Earnings (Loss) Per Share Before Tax   | \$ 0.01          | \$ ( 0.00)          | \$ 0.00         | \$ 0.00         |
| Basic Earnings (Loss) Per Share After Tax    | \$ 0.01          | \$ ( 0.00)          | \$ 0.00         | \$ 0.00         |
|  |                  |                     |                 |                 |
| Diluted Earnings (Loss) Per Share Before Tax | \$ 0.01          | \$ ( 0.00)          | \$ 0.00         | \$ 0.00         |
| Diluted Earnings (Loss) Per Share After Tax  | \$ 0.01          | \$ ( 0.00)          | \$ 0.00         | \$ 0.00         |

(See "Notes to Financial Statements")

## STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(as prepared by Management)  
(Unaudited)

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|  | <u>Three Months Ended</u> |                      | <u>Six Months Ended</u> |                      |
|--|---------------------------|----------------------|-------------------------|----------------------|
|  | <u>June 30, 2006</u>      | <u>June 30, 2005</u> | <u>June 30, 2006</u>    | <u>June 30, 2005</u> |
| NET INCOME (LOSS)  | \$ 35,304                 | \$ (14,718)          | \$ 5,305                | \$ 5,247             |
| OTHER COMPREHENSIVE GAIN (LOSS):   |                           |                      |                         |                      |
| Unrealized gain (loss) on securities arising during period (net of tax effect) | <u>1,862</u>              | <u>1,609</u>         | <u>3,950</u>            | <u>( 749)</u>        |
| COMPREHENSIVE INCOME (LOSS)  | <u>\$ 37,166</u>          | <u>\$ ( 13,109)</u>  | <u>\$ 9,255</u>         | <u>\$ 4,498</u>      |

(See "Notes To Financial Statements")

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ELECTRONIC SYSTEMS TECHNOLOGY, INC.  
STATEMENTS OF CASH FLOWS

(as prepared by Management)  
(Unaudited)

| Six Months Ended   | <u>June 30, 2006</u> | <u>June 30, 2005</u> |
|--|----------------------|----------------------|
| <b>CASH FLOWS PROVIDED (USED) IN OPERATING ACTIVITIES:</b> |                      |                      |
| Net Income (Loss)  | \$ 5,305             | \$ 5,247             |
| Noncash items included in income:                          |                      |                      |
| Depreciation   | 29,028               | 35,428               |
| Amortization   | 748                  | 1,426                |
| Loss on Disposition of Assets                              | --                   | 132                  |
| Loss on Marketable Securities                              | 8,942                | 7,140                |
| Provision for Federal Income Taxes                         | ( 5,510)             | ( 2,042)             |
| Accrued Interest   | 1,392                | ( 1,998)             |
| Deferred Income Tax  | ( 11,200)            | 3,200                |
| Share Based Compensation                                   | 3,994                | --                   |
| <b>DECREASE (INCREASE) IN CURRENT ASSETS:</b>              |                      |                      |
| Accounts Receivable Net                                    | 63,869               | 40,520               |
| Certificates of Deposit Redeemed (Purchased)               | 90,000               | ( 450,000)           |
| Marketable Securities Investments Purchased                | ( 402,000)           | --                   |
| Marketable Securities Investments Sold                     | 292,042              | 595,028              |



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|  |                   |                   |
|--|-------------------|-------------------|
| Inventory  | ( 90,155)         | ( 5,691)          |
| Prepaid Software and Network Services                | 8,215             | ( 16,305)         |
| Prepaid Expenses                                     | ( 12,993)         | ( 3,089)          |
| DECREASE (INCREASE) IN LONG TERM ASSETS:             |                   |                   |
| Prepaid Software and Network Services                | --                | ( 28,535)         |
| INCREASE (DECREASE) IN CURRENT LIABILITIES:          |                   |                   |
| Accounts Payable and Accrued Expenses                | 50,316            | ( 62,825)         |
| Refundable Deposits                                  | 55                | ( 43)             |
| Deferred Tax Liability                               | --                | ( 2,300)          |
| Accrued Federal Income Taxes                         | ( 62,534)         | ( 23,343)         |
|  | <u>( 30,486)</u>  | <u>91,950</u>     |
| CASH FLOWS PROVIDED (USED) IN INVESTING ACTIVITIES:  |                   |                   |
| Additions To Property And Equipment                  | <u>( 23,446)</u>  | <u>( 17,050)</u>  |
|  | <u>( 23,446)</u>  | <u>( 17,050)</u>  |
| CASH FLOWS PROVIDED (USED) IN FINANCING ACTIVITIES:  |                   |                   |
| Stock option exercise                                | <u>2,000</u>      | <u>--</u>         |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS |                   |                   |
|  | (51,932)          | 74,900            |
| Cash And Cash Equivalents At Beginning Of Period     | <u>651,265</u>    | <u>488,480</u>    |
| Cash And Cash Equivalents At Ending of Period        | <u>\$ 599,333</u> | <u>\$ 563,380</u> |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION:  |                   |                   |
| Cash Paid Year To Date:                              |                   |                   |

|                                      |                   |                   |
|--------------------------------------|-------------------|-------------------|
| Interest                             | \$ 0              | \$ 0              |
| Federal Income Taxes                 | <u>\$ 80,579</u>  | <u>\$ 39,201</u>  |
|                                      |                   |                   |
| Cash allocated for Cash Distribution | <u>\$ 51,537</u>  | <u>\$ 51,487</u>  |
|                                      |                   |                   |
| Cash And Cash Equivalents:           |                   |                   |
| Cash                                 | \$ 4,702          | \$ 11,100         |
| Money Market Accounts                | <u>594,631</u>    | <u>552,280</u>    |
|                                      | <u>\$ 599,333</u> | <u>\$ 563,380</u> |

(See "Notes to Financial Statements")

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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 10QSB are unaudited and reflect, in the opinion of Management, a fair presentation of operations for the three and six months ended June 30, 2006 and June 30, 2005. 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. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Form 10KSB for the year ended December 31, 2005 as filed with Securities and Exchange Commission.

The results of operations for the three and six months ended June 30, 2006 and June 30, 2005, 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 cost or market with cost determined using the FIFO (first in, first out) method. Inventories consist of the following:

|  |                        |                            |
|--|------------------------|----------------------------|
|  | June 30<br><u>2006</u> | December 31<br><u>2005</u> |
|--|------------------------|----------------------------|

|                  |                  |                   |
|------------------|------------------|-------------------|
| Parts            | \$290,809        | \$ 293,077        |
| Work in progress | 85,781           | 14,518            |
| Finished goods   | <u>198,822</u>   | <u>177,662</u>    |
|                  | <u>\$575,412</u> | <u>\$ 485,257</u> |

## NOTE 3 EARNINGS (LOSS) PER SHARE

Basic EPS excludes dilution and is computed by dividing income 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 5,152,258 and 5,148,667 for the six months ended June 30, 2006 and 2005 respectively. The primary weighted average number of common shares outstanding for the three month period ending June 30, 2006 was 5,153,667.

| <u>For the three months ended June 30, 2006</u>                                     |                           |                             |                         |
|---|---------------------------|-----------------------------|-------------------------|
|   | <u>Income (Numerator)</u> | <u>Shares (Denominator)</u> | <u>Per Share Amount</u> |
| <u>Basic EPS</u><br>Income available to common stockholders                         | <u>\$35,304</u>           | 5,153,667                   | <u>\$0.01</u>           |
| <u>Diluted EPS</u><br>Income available to common stockholders + assumed conversions | <u>\$35,304</u>           | 5,165,921                   | <u>\$0.01</u>           |

## 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.

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As of June 30, 2006, the Company had stock options outstanding, which have been granted periodically to individual employees and directors with no less than three years of continuous tenure with Company. On February 10, 2006, 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 10, 2006 totaled 215,000 shares under option and have an exercise price of \$0.68 per share. The options granted on February 10, 2006 may be exercised any time during the period from February 10, 2006 through February 9, 2009. The Company's Form 8-K dated February 10, 2006, as filed with the Securities and Exchange Commission is included 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:

|                          | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|--------------------------|-------------|-------------|-------------|-------------|
| Dividend yield           | 1.43%       | 1.25%       | 1.15%       | 3.49%       |
| Expected volatility      | 49%         | 63%         | 65%         | 73%         |
| Risk-free interest rate  | 4.67%       | 3.65%       | 2.25%       | 2.04%       |
| Expected term (in years) | 3           | 3           | 3           | 3           |

The Company uses historical data to estimate option exercise rates. The option exercise rate for option grants in 2006 through 2003 was twelve percent.

A summary of option activity during the six months ended June 30, 2006 is as follows:

|                                | Number Outstanding | Weighted-Average Exercise Price Per Share |
|--------------------------------|--------------------|---|
| Outstanding at January 1, 2006 | 545,000            | \$0.68                                    |
| Granted                        | 215,000            | 0.68                                      |
| Exercised                      | (5,000)            | 0.40                                      |
| Canceled                       | (150,000)          | 0.40                                      |
| Outstanding at June 30, 2006   | 605,000            | 0.75                                      |

For the second quarter of 2006, compensation expense charged against income for stock options was \$1,990 (\$1,313 after tax). No non-vested share-based compensation arrangements existed as of June 30, 2006.

NOTE 5 - OTHER COMPREHENSIVE INCOME (LOSS)

For the quarter ended June 30, 2006, the Company's only item of other comprehensive income (loss) was unrealized gain on marketable securities investments, net of tax in the amount of \$1,862, resulting from changes in value of mutual fund investments held by the Company. During the second quarter of 2005, the only item of comprehensive income (loss) was unrealized gain on marketable securities investments, net of tax in the amount of \$1,609.

## NOTE 6 - RELATED PARTY TRANSACTIONS

For the six-month period ended June 30, 2006, services in the amount of \$68,094 were contracted with Manufacturing Services, Inc., of which the owner/president is a member of the Board of Directors of the Company.

## NOTE 7 - 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, 2006, Domestic customers represented approximately 78% of total net revenues. Foreign customers represented approximately 22% of total net revenues. During the quarter ended June 30, 2006 sales to the ADSI, a domestic reseller of the Company's products consisted of 17% of the Company's sales revenues. No other sales to a single customer comprised 10% or

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more of the Company's product sales. Revenues from foreign countries consist primarily of revenues from Canada and South American countries including Mexico.

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 2005 and 2006 is as follows: |                 |                |                              |              |
|  | <u>Domestic</u> | <u>Foreign</u> | <u>Unallocated Corporate</u> | <u>Total</u> |
| <b><u>Three months ended June 30, 2006</u></b>   |                 |                |                              |              |
| Total net revenues   | \$499,558       | \$141,412      | \$ -                         | \$640,970    |

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|  |             |           |           |             |
|--|-------------|-----------|-----------|-------------|
| Earnings (loss) before tax                     | 82,705      | 46,140    | (67,059)  | 61,786      |
| Depreciation/amortization                      | 14,458      | -         | 558       | 15,016      |
| Identifiable assets                            | 762,240     | 19,259    | 2,214,314 | 2,995,813   |
| Net capital expenditures                       | 11,814      | -         | -         | 11,814      |
| <b><u>Three months ended June 30, 2005</u></b> |             |           |           |             |
| Total net revenues                             | \$485,498   | \$61,680  | \$ -      | \$547,178   |
| Earnings (loss) before tax                     | 53,876      | (8,543)   | (62,696)  | (17,363)    |
| Depreciation/amortization                      | 17,787      | -         | 676       | 18,463      |
| Identifiable assets                            | 812,844     | 32,952    | 2,058,199 | 2,903,995   |
| Net capital expenditures                       | 1,346       | -         | -         | 1,346       |
| <b><u>Six months ended June 30, 2006</u></b>   |             |           |           |             |
| Total net revenues                             | \$840,027   | \$288,776 | \$ -      | \$1,128,803 |
| Earnings (loss) before tax                     | 57,664      | 93,553    | (144,577) | 6,640       |
| Depreciation/amortization                      | 22,261      | -         | 7,515     | 29,776      |
| Identifiable assets                            | 762,240     | 19,259    | 2,214,314 | 2,995,813   |
| Net capital expenditures                       | 22,846      | -         | 600       | 23,446      |
| <b><u>Six Months ended June 30, 2005</u></b>   |             |           |           |             |
| Total net revenues                             | \$1,006,644 | \$123,540 | \$ -      | \$1,130,184 |
| Earnings (loss) before tax                     | 127,771     | (3,788)   | (138,699) | (14,716)    |
| Depreciation/amortization                      | 35,502      | -         | 1,352     | 36,854      |
| Identifiable assets                            | 812,844     | 32,952    | 2,058,199 | 2,903,995   |

|                          |        |   |   |        |
|--------------------------|--------|---|---|--------|
| Net capital expenditures | 17,050 | - | - | 17,050 |
|--------------------------|--------|---|---|--------|

## NOTE 8 - CASH DISTRIBUTION

On June 2, 2006, the Company declared a one-time, non-cumulative, cash distribution to shareholders of record as of June 23, 2006, of \$0.01 per share of common stock, with a payable date of July 17, 2006. The payment of the cash distribution was completed by July 17, 2006. For the quarter ended June 30, 2006, the Company recognized a current liability in the amount of \$51,537, reflecting the total dollar value of the cash distribution. The Company's Form 8-K dated June 2, 2006, as filed with the Securities and Exchange Commission is included herein by reference.

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Item 2.

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, 2006. 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 \$640,970 for the second quarter of 2006, compared to \$547,178 for the second quarter of 2005, reflecting an increase of 17%. Gross revenues increased to \$652,474 for the quarter ended June 30, 2006, from \$556,989 for the same quarter of 2005. Year to date sales decreased slightly to \$1,128,803 as of June 30, 2006 as compared to \$1,130,184 as of June 30, 2005. Year to date gross revenues increased to \$1,151,738 as of June 30, 2006 compared to \$1,146,318 as of June 30, 2005. The increase in revenues for the second quarter of 2006 is the result of increased foreign and domestic industrial automation and domestic Mobile Data Computer Systems (MDCS) product sales when compared with the same period of 2005. Management believes the revenue increase is the result of the culmination of several foreign and domestic projects using the Company's products coming to completion, as well as the result of increased tradeshow attendance by the Company during the past six months. Management remains cautious that 2006 sales revenues may be negatively impacted by competitive and economic factors that led to flat sales revenues during 2005, particularly in the domestic industrial automation marketplace. The Company continues to increase tradeshow attendance for specifically targeted markets of the Company's products to increase product exposure and customer and reseller contact.

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 2006 and 2005 are as follows:

| For the second quarter of |             |             |
|---------------------------|-------------|-------------|
|                           | <u>2006</u> | <u>2005</u> |
| Domestic Sales            | 78%         | 89%         |
| Export Sales              | 22%         | 11%         |

## 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 7 - Segment Reporting".

### Domestic Revenues

During the quarter ended June 30, 2006, the Company's domestic operations represented 78% of the Company's total net 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 revenues increased to \$499,558 for the quarter ended June 30, 2006, compared to \$485,498 for the quarter ended June 30, 2005, reflecting an increase of 3%. Management believes the increase in domestic sales revenues is the result of strong MDCS sales from the Company's ongoing project with the Mississippi Highway Patrol, which was accelerated by the customer during the second quarter of 2006. A slight increase in domestic industrial automation sales was also recorded during the quarter resulting from timing differences in projects involving the Company's products, as well as the results of increased tradeshow activity by the Company.

The Company's domestic sales were augmented by sales of the Company's products for MDCS projects to public entities, which accounted for 32% of the Company's domestic sales during the second quarter of 2006. Management believes MDCS sales will remain strong in the near term, however MDCS sales are difficult to predict and cannot be assured due to public safety entity purchases being

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linked to uncertain government funding. During the quarter ended June 30, 2006 sales to the ADSI, a domestic reseller of the Company's products consisted of 17% of the Company's sales revenues. No other sales to a single customer comprised 10% or more of the Company's product sales.

Domestic segment operating income increased to \$82,705 for the quarter ended June 30, 2006 as compared with a segment operating income of \$53,876 for the same quarter of 2005, due to increased sales revenues and investment returns for the segment during the second quarter of 2006.

For the six-month period ended June 30, 2006, the Company's domestic operations represented 74% of the Company's total net revenues. Year to date domestic revenues decreased to \$840,027 as of June 30, 2006, compared to \$1,006,644 for the same period of 2005, reflecting a decrease of 17%. Management believes the decrease in domestic sales revenues during the first half of 2006 is a continuation of the effect of competitive and economic pressures that effected domestic industrial automation sales during the majority of 2005. 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 32% of the Company's domestic sales during the first six months of 2006.



Year to date domestic segment operating income decreased to \$57,664 for the period ended June 30, 2006 as compared with a segment operating income of \$127,771 for the same period of 2005, due to decreased sales revenues and increased operating expenses for the segment when compared with 2005.

#### Foreign Revenues

The Company's foreign operating segment represented 22% of the Company's total net revenues for the quarter ended June 30, 2006. 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, 2006, the Company had \$141,412 in foreign export sales, amounting to 22% of total net revenues of the Company for the quarter, compared with foreign export sales of \$61,680 for the same quarter of 2005, reflecting an increase of 129%. This increase is attributable to increased sales revenues for a large industrial automation project in Colombia, as well as increased sales in Canada, Croatia, Mexico, Singapore and Venezuela, when compared with the same period of 2005. No foreign sales to a single customer comprised 10% or more of the Company's product sales for the quarter ended June 30, 2006. Products purchased by foreign customers were used primarily in industrial automation applications. Management believes 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 \$46,140 for the quarter ended June 30, 2006 as compared with a net operating loss of \$8,543 for the same period of 2005 due to the strong increase in sales revenues.

For the six-month period ended June 30, 2006, the Company had \$288,776 in foreign export sales, amounting to 26% of total net revenues of the Company for the period, compared with foreign export sales of \$123,540 for the same period of 2005, reflecting an increase of 134%. This increase is attributable to sales revenues for a large industrial automation project in Colombia, as well as increased sales in Canada, Croatia, Mexico, Singapore and Venezuela, when compared with the first six months of 2005. Products purchased by foreign customers were used primarily in industrial automation applications.

Year to date foreign segment operating income increased to \$93,553 for the period ended June 30, 2006 as compared with a segment operating loss of \$3,788 for the same period of 2005, due to increased sales revenues for the segment when compared with 2005.

#### 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, include salaries, wages and other expenses related to the performance of these support functions. Unallocated corporate expenses increased slightly during the quarter ended June 30, 2006 to \$67,059 as compared with \$62,696 for the same quarter of 2005, and represented expense to total net revenues percentages of 10% and 11% for the first quarter of 2006 and 2005, respectively.

Year to date unallocated corporate expenses increased slightly for the period ended June 30, 2006 to \$144,577 as compared with \$138,699 for the same period of 2005, and represented expense to total net revenues percentages of 13% and 12% for the first six months of 2006 and 2005, respectively.

**BACKLOG:**

The Corporation had backlog of \$48,300 as of June 30, 2006. 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 2006 and 2005 was 40% and 51%, respectively. The cost of sales decrease for the second quarter of 2006 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 2005. The cost of sales percentage was also positively effected by increased profit margins on engineering services performed by the Company resulting from a restructuring of customer service engineering compensation late in the first quarter of 2006.

**OPERATING EXPENSES:**

Operating expenses for the second quarter of 2006 increased \$43,733 from the second quarter of 2005. The following is an outline of operating expenses:

| For the quarter ended:   | <u>June 30, 2006</u> | <u>June 30, 2005</u> | <u>Increase (Decrease)</u> |
|--------------------------|----------------------|----------------------|----------------------------|
| Finance/Administration   | \$ 66,959            | \$ 62,696            | \$ 4,263                   |
| Research/Development     | 91,409               | 69,659               | 21,750                     |
| Marketing                | 142,662              | 129,733              | 12,929                     |
| Customer Service         | <u>31,757</u>        | <u>26,966</u>        | <u>4,791</u>               |
| Total Operating Expenses | <u>\$ 332,787</u>    | <u>\$ 289,054</u>    | <u>\$ 43,733</u>           |

**FINANCE AND ADMINISTRATION:**

During the second quarter of 2006, Finance and Administration expenses increased \$4,263 from the same quarter of 2005. The increase is the result of increased professional services required by the Company for government compliance and administration, and the recognition of share based compensation expense by the Company when compared with the same quarter of 2005.

**RESEARCH AND DEVELOPMENT:**

Research and Development expenses increased \$21,750 during the second quarter of 2006, when compared with the same period in 2005. The increase is primarily due to increased subcontracted engineering expertise and development related material when compared with the same quarter of 2005.

**MARKETING:**

During the second quarter of 2006, marketing expenses increased \$12,929 from the same period in 2005. The increase is due to attendance of an increased number of tradeshows by the Company, resulting in increased tradeshow fees and travel expenses when compared with the same period of 2005.

CUSTOMER SERVICE:

Customer service expenses increased \$4,791 during the second quarter of 2006, when compared with the same quarter of 2005. The increase is due to a reduced amount of department expenses being billed directly to customers compared with the same quarter of 2005.

INTEREST AND DIVIDEND INCOME:

The Corporation earned \$11,504 in interest and dividend income during the quarter ended June 30, 2006. Sources of this income were money market accounts, certificates of deposit and marketable securities investments.

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NET INCOME (LOSS):

The Company had a net income of \$35,304 for the second quarter of 2006, compared to a \$14,718 net loss for the same quarter of 2005. The increased in profitability for the quarter ended June 30, 2006 is attributable to both increased sales revenues and increased profit margins when compared with the same quarter of 2005. For the six-month period ended June 30, 2006, the Company recorded a net income of \$5,305 compared with net income of \$5,247 for the same period of 2005, the result of increased operating expenses when compared with 2005.

B. Financial Condition, Liquidity and Capital Resources

The Corporation's current asset to current liabilities ratio at June 30, 2006 was 12.9:1 compared to 15.7:1 at December 31, 2005. The decrease in current ratio is the result of increased accounts payable and distributions payable liabilities as of June 30, 2006 when compared with year end 2005. For the quarter ending June 30, 2006, the Company had cash and cash equivalents of \$599,333, compared to cash and cash equivalent holdings of \$651,265 at December 31, 2005. Available for sale marketable securities increased to \$1,038,224 compared to \$921,029 at December 31, 2005, a result of timing differences in the Company's investments between marketable securities and certificates of deposit. The Company had certificates of deposit investments in the amount of \$359,640 as of June 30, 2006 as compared to \$449,613 as of December 31, 2005. Certain components of investments held by the Company, if sold as of June 30, 2006, would have presented a realized loss net of tax of \$6,321, as compared with a potential loss net of tax, of \$17,017 as of December 31, 2005. The contingency for these items is reflected in the Balance Sheet as Accumulated Other Comprehensive Gain (Loss), and the Statement of Comprehensive Income (Loss), respectively, as of June 30, 2006.

Accounts receivable decreased to \$159,113 as of June 30, 2006, from December 31, 2005 levels of \$222,982, due to sales and collection differences during the second quarter of 2006, when compared with year end 2005. Inventory increased to \$575,412 at June 30, 2006, from December 31, 2005 levels of \$485,257, due to increased purchasing of component materials during the first six months of 2006. The Company's fixed assets, net of depreciation, decreased to \$178,443 as of June 30, 2006, from December 31, 2005 levels of \$184,025, due to depreciation of \$29,028, and was offset by capital expenditures of \$23,446 for fixed assets. The Company's capital expenditures for fixed assets were primarily production/development-related equipment and tradeshow display enhancements. Management foresees additional capital expenditures may be necessary in 2006 to support the production and sale of the Company's products.

As of January 1, 2005, the Company entered into a 39-month agreement with Netsuite Inc. to provide the Company's customer relationship management and accounting software and related network infrastructure services. The current portion of the prepaid Netsuite Inc. services as of June 30, 2006 is reflected in "prepaid expenses" on the Company's balance sheet in the amount of \$18,876. The noncurrent portion of the prepaid Netsuite Inc. services as of June 30, 2006 is reflected in "other assets" on the Company's balance sheet in the amount of \$15,079.

As of June 30, 2006, the Company's trade accounts payable balance was \$99,487 as compared with \$41,377 at December 31, 2005, and reflects amounts owed for inventory items, contracted services, and state tax liabilities. Accrued liabilities as of June 30, 2006 were \$46,315, compared with \$54,109 at December 31, 2005, and reflect items such as accrued vacation benefits. The Company announced a cash distribution, payable during July 2006 in the amount of \$51,537, which has been recognized as a liability as of June 30, 2006. Federal income taxes payable decreased to \$18,045 as of June 30, 2006 a result of the Company's decreased profitability during the first half of 2006.

In Management's opinion, the Company's cash and cash equivalent reserves, and working capital at June 30, 2006 is sufficient to satisfy requirements for operations, capital expenditures, and other expenditures as may arise during the remainder of 2006.

**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.

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Item 3.

### CONTROLS & PROCEDURES

The Company maintains disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the specified time periods.

### CEO and CFO CERTIFICATIONS

Appearing immediately following the Signatures section of this Quarterly Report there are two separate forms of "Certifications" of the CEO. The second form of Certification is required in accord with Section 302 of the Sarbanes-Oxley Act of 2002 (the Section 302 Certification). This section of the Quarterly Report, which you are currently reading is the information concerning the Controls Evaluation referred to in the Section 302 Certifications and this information should be read in conjunction with the Section 302 Certifications for a more complete understanding of the topics presented.

### DISCLOSURE CONTROLS AND INTERNAL CONTROLS.

Disclosure Controls are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 (Exchange Act), such as this Quarterly

Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's (SEC) rules and forms. Disclosure Controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Internal Controls are procedures which are designed with the objective of providing reasonable assurance that (1) our transactions are properly authorized; (2) our assets are safeguarded against unauthorized or improper use; and (3) our transactions are properly recorded and reported, all to permit the preparation of our financial statements in conformity with generally accepted accounting principles. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, Our CEO and CFO have concluded that our disclosure controls and procedures were effective at that reasonable assurance level for the period stated.

#### LIMITATIONS ON THE EFFECTIVENESS OF CONTROLS.

The Company's management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our Disclosure Controls or our Internal Controls will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance 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. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

#### CONCLUSION

Accordingly, the CEO and CFO note that, as of the period ended June 30, 2006 covered by this report, there were no significant deficiencies and material weaknesses in our Internal Controls. The effectiveness of these controls are under the continuing review of the Company's CEO, CFO and CAO. In addition, Management has begun its project to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. Management anticipates that this effort will also help to more formally document, communicate, and comply with the Company's accounting policies and procedures, as well as to identifying and rectifying any residual disclosure or reporting process control issues that may exist but, at this time, are unknown to management. There were no other changes in our 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 2, 2006, in Kennewick, Washington the following items were voted on by the stockholders with the following outcomes:

Item #1 Election of Directors:

Melvin Brown

|                      |                 |                   |
|----------------------|-----------------|-------------------|
| Votes for: 4,106,512 | Against: 28,200 | Abstaining: 1,500 |
|----------------------|-----------------|-------------------|

Jon Correio

|                      |                 |                   |
|----------------------|-----------------|-------------------|
| Votes for: 4,107,212 | Against: 26,000 | Abstaining: 3,000 |
|----------------------|-----------------|-------------------|

Robert Southworth

|                      |            |                   |
|----------------------|------------|-------------------|
| Votes for: 4,128,312 | Against: 0 | Abstaining: 7,900 |
|----------------------|------------|-------------------|

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, 2006.

|                      |                       |                   |
|----------------------|-----------------------|-------------------|
| Votes for: 4,120,412 | Votes against: 10,800 | Abstaining: 5,000 |
|----------------------|-----------------------|-------------------|

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

(b) Reports on Form 8-K

Form 8-K dated February 10, 2006 is incorporated herein by reference.

Form 8-K dated June 2, 2006 is incorporated herein by reference.

|                |                               |
|----------------|-------------------------------|
| Exhibit Index  | Reference Form 10-QSB         |
| Exhibit Number | Notes to Financial Statements |

4. Instruments defining the Rights of Security Holders including indentures.

Form 8K dated February 10, 2006 is incorporated herein by reference

|   |                                |
|---|--------------------------------|
| 11. Statement Re: computation of per share earnings | Note 3 to Financial Statements |
|---|--------------------------------|

31.1 CEO Certification

31.2 CFO Certification

32 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 7, 2006 | /s/ T.L. KIRCHNER  |
|                      | Name: T.L. Kirchner  |
|                      | Title: Director/President<br>(Principal Executive Officer) |

|                      |  |
|----------------------|--|
| Date: August 7, 2006 | /s/ JON CORREIO  |
|                      | Name: Jon Correio  |
|                      | Title: Director/Secretary/Treasurer<br>(Principal Financial Officer) |

