

ELECTRONIC SYSTEMS TECHNOLOGY INC  
Form 10QSB  
November 14, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON D.C. 20549  
FORM 10-QSB

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

|                                 |                   |
|---------------------------------|-------------------|
| For the quarterly period ended: | September 30 2005 |
|---------------------------------|-------------------|

|                         |           |
|-------------------------|-----------|
| 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 B  
Kennewick WA 99336

|   |                |
|---|----------------|
| Registrant's telephone number, including area code: | (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 [ X ] No [ ]

The number of shares outstanding of common stock as of September 30, 2005 was 5,148,667.

## PART I - FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS.

## ELECTRONIC SYSTEMS TECHNOLOGY, INC.

(as prepared by Management)  
(Unaudited)

## SELECTED FINANCIAL DATA

| Nine Months Ended                      | <u>September 30, 2005</u> | <u>September 30, 2004</u> |
|--|---------------------------|---------------------------|
| Sales                                  | \$ 1,780,378              | \$ 1,789,944              |
| Other Revenues                         | 27,393                    | 16,861                    |
| Gross Profit                           | 954,104                   | 1,011,359                 |
|  |                           |                           |
| Net Income (Loss) Before Taxes         | 139,823                   | 218,401                   |
| Net Income (Loss) After Taxes          | 86,193                    | 144,151                   |
|  |                           |                           |
| Earnings (Loss) Per Share Before Taxes |                           |                           |
| Basic                                  | \$ 0.03                   | \$ 0.04                   |
| Diluted                                | 0.03                      | 0.04                      |
|  |                           |                           |
| Earnings (Loss) Per Share After Taxes  |                           |                           |
| Basic                                  | \$ 0.02                   | \$ 0.03                   |
| Diluted                                | 0.02                      | 0.03                      |
|  |                           |                           |
| Weighted Average Shares Outstanding    |                           |                           |
| Primary                                | 5,148,667                 | 5,098,667                 |
| Diluted                                | 5,227,891                 | 5,268,324                 |

|  |              |              |
|--|--------------|--------------|
|  |              |              |
| Total Assets                                 | \$ 2,978,294 | \$ 2,870,903 |
|  |              |              |
| Long-Term Debt and Capital Lease Obligations | \$ 0         | \$ 0         |
|  |              |              |
| Shareholders' Equity                         | \$ 2,735,351 | \$ 2,651,522 |
|  |              |              |
| Shareholders' Equity Per Share               | \$ 0.53      | \$ 0.52      |
|  |              |              |
| Working Capital                              | \$ 2,540,385 | \$ 2,472,977 |
|  |              |              |
| Current Ratio                                | 15.5:1       | 16.5:1       |
|  |              |              |
| Equity To Total Assets                       | 92%          | 92%          |

ELECTRONIC SYSTEMS TECHNOLOGY, INC.  
BALANCE SHEETS

(as prepared by Management)  
(Unaudited)

|        | <u>September 30, 2005</u> | <u>December 31, 2004</u> |
|--------|---------------------------|--------------------------|
| ASSETS |                           |                          |

| CURRENT ASSETS   |                     |                     |
|--|---------------------|---------------------|
| Cash and Cash Equivalents  | \$ 392,228          | \$ 488,480          |
| Short Term Certificates of Deposit Investments   | 449,370             | --                  |
| Available for Sale Marketable Securities   | 925,934             | 1,344,619           |
| Accounts Receivable, Net of Allowance for Uncollectibles   | 311,966             | 257,080             |
| Inventory  | 587,272             | 605,159             |
| Accrued Interest   | 4,065               | --                  |
| Prepaid Expenses   | 26,089              | 12,578              |
| Prepaid Software/Network Services-current portion  | <u>18,104</u>       | --                  |
| Total Current Assets   | <u>2,715,028</u>    | <u>2,707,916</u>    |
|  |                     |                     |
| PROPERTY & EQUIPMENT Net of Depreciation of \$524,968 at September 30, 2005 and \$476,185 at December 31, 2004 | <u>217,196</u>      | <u>253,456</u>      |
|  |                     |                     |
| OTHER ASSETS   |                     |                     |
| Deferred Income Tax Benefit  | <u>15,700</u>       | <u>17,300</u>       |
| PREPAID SOFTWARE/NETWORK SERVICES-long term portion  | <u>27,884</u>       | --                  |
| TOTAL ASSETS   | <u>\$ 2,978,294</u> | <u>\$ 2,983,296</u> |
|  |                     |                     |
| LIABILITIES & STOCKHOLDERS' EQUITY   |                     |                     |
|  |                     |                     |
| CURRENT LIABILITIES  |                     |                     |
| Accounts Payable   | 68,827              | 96,949              |
| Refundable Deposits  | 7,667               | 3,630               |

|   |                     |                     |
|---|---------------------|---------------------|
| Accrued Liabilities   | 37,949              | 69,255              |
| Federal Income Taxes Payable  | <u>60,200</u>       | <u>39,201</u>       |
| Total Current Liabilities   | <u>174,643</u>      | <u>209,035</u>      |
|   |                     |                     |
| Deferred Income Taxes   | 68,300              | 75,500              |
|   |                     |                     |
| STOCKHOLDERS' EQUITY<br>Common Stock, \$.001 Par Value 50,000,000<br>Shares Authorized 5,148,667 Shares Issued And<br>Outstanding | 5,149               | 5,149               |
| Additional Paid-in Capital  | 966,184             | 966,184             |
| Retained Earnings   | 1,777,958           | 1,743,252           |
| Accumulated Other Comprehensive Gain (Loss)   | <u>(13,940)</u>     | <u>(15,824)</u>     |
|   |                     | <u>2,698,761</u>    |
| <u>2,735,351</u>  |                     |                     |
|   |                     |                     |
| TOTAL LIABILITIES AND STOCKHOLDERS'<br>EQUITY   | <u>\$ 2,978,294</u> | <u>\$ 2,983,296</u> |

(See "Notes to Financial Statements")

ELECTRONIC SYSTEMS TECHNOLOGY, INC.  
STATEMENTS OF OPERATIONS

(as prepared by Management)  
(Unaudited)

|               | Three Months Ended                  |                                     | Nine Months Ended                   |                                     |
|---------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
|               | <u>September 30,</u><br><u>2005</u> | <u>September 30,</u><br><u>2004</u> | <u>September 30,</u><br><u>2005</u> | <u>September 30,</u><br><u>2004</u> |
| SALES         | <u>\$ 650,195</u>                   | <u>\$ 457,485</u>                   | <u>\$ 1,780,378</u>                 | <u>\$ 1,789,944</u>                 |
| COST OF SALES | <u>277,890</u>                      | <u>220,707</u>                      | <u>826,274</u>                      | <u>778,585</u>                      |

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|  |                  |                   |                  |                   |
|--|------------------|-------------------|------------------|-------------------|
| Gross Profit                               | <u>372,305</u>   | <u>236,778</u>    | <u>954,104</u>   | <u>1,011,359</u>  |
| OPERATING EXPENSES                         |                  |                   |                  |                   |
| Finance/Administration                     | 43,044           | 40,379            | 181,743          | 154,053           |
| Research & Development                     | 66,934           | 85,858            | 203,285          | 237,586           |
| Marketing                                  | 129,057          | 94,702            | 363,823          | 321,076           |
| Customer Service                           | <u>22,324</u>    | <u>24,882</u>     | <u>78,552</u>    | <u>90,138</u>     |
| Total Operating Expense                    | <u>261,359</u>   | <u>245,821</u>    | <u>827,403</u>   | <u>802,853</u>    |
| OPERATING INCOME (LOSS)                    | <u>110,946</u>   | <u>(9,043)</u>    | <u>126,701</u>   | <u>208,506</u>    |
| Other Income (Expenses)                    |                  |                   |                  |                   |
| Interest/Investment Income                 | 11,259           | 5,916             | 27,393           | 14,603            |
| Realized Loss on Marketable Securities     | --               | --                | (7,140)          | --                |
| Management Fee, Marketable Securities      | (2,344)          | (2,312)           | (6,999)          | (6,962)           |
| Uncollectible Amounts Recovered            | --               | 81                | --               | 2,258             |
| Loss on Asset Disposal                     | --               | --                | <u>(132)</u>     | <u>(4)</u>        |
| Net Other Income (Expense)                 | <u>8,915</u>     | <u>3,685</u>      | <u>13,122</u>    | <u>9,895</u>      |
| INCOME (LOSS) BEFORE TAX                   | 119,861          | ( 5,358)          | 139,823          | 218,401           |
| Provision For Income Tax                   | <u>(38,914)</u>  | <u>1,822</u>      | <u>(53,630)</u>  | <u>(74,250)</u>   |
| NET INCOME (LOSS)                          | <u>\$ 80,947</u> | <u>\$ (3,536)</u> | <u>\$ 86,193</u> | <u>\$ 144,151</u> |
| Basic Earnings (Loss) Per Share Before Tax | \$ 0.02          | \$ ( 0.00)        | \$ 0.03          | \$ 0.04           |

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|  |         |            |         |         |
|--|---------|------------|---------|---------|
| Basic Earnings (Loss) Per Share After Tax    | \$ 0.02 | \$ ( 0.00) | \$ 0.02 | \$ 0.03 |
|  |         |            |         |         |
| Diluted Earnings (Loss) Per Share Before Tax | \$ 0.02 | \$ ( 0.00) | \$ 0.03 | \$ 0.04 |
| Diluted Earnings (Loss) Per Share After Tax  | \$ 0.02 | \$ ( 0.00) | \$ 0.02 | \$ 0.03 |

(See "Notes to Financial Statements")

STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(as prepared by Management)  
(Unaudited)

|  | <u>Three Months Ended</u> |                           | <u>Nine Months Ended</u>  |                           |
|--|---------------------------|---------------------------|---------------------------|---------------------------|
|  | <u>September 30, 2005</u> | <u>September 30, 2004</u> | <u>September 30, 2005</u> | <u>September 30, 2004</u> |
| NET INCOME (LOSS)  | \$ 80,947                 | \$ (3,536)                | \$ 86,193                 | \$ 144,151                |
| OTHER COMPREHENSIVE GAIN (LOSS):   |                           |                           |                           |                           |
| Unrealized gain (loss) on securities arising during period (net of tax effect) | <u>( 2,080)</u>           | <u>3,094</u>              | <u>( 2,829)</u>           | <u>( 2,420)</u>           |
| COMPREHENSIVE INCOME (LOSS)  | <u>\$ 78,867</u>          | <u>\$ ( 442)</u>          | <u>\$ 83,364</u>          | <u>\$ 141,731</u>         |

(See "Notes To Financial Statements")

ELECTRONIC SYSTEMS TECHNOLOGY, INC.  
STATEMENTS OF CASH FLOWS

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(as prepared by Management)  
(Unaudited)

| Nine Months Ended  | <u>September 30, 2005</u> | <u>September 30,<br/>2004</u> |
|--|---------------------------|-------------------------------|
| <b>CASH FLOWS PROVIDED (USED) IN OPERATING ACTIVITIES:</b> |                           |                               |
| Net Income (Loss)  | \$86,193                  | \$144,151                     |
| Noncash items included in income:                          |                           |                               |
| Depreciation   | 53,178                    | 40,450                        |
| Amortization   | 2,138                     | 3,192                         |
| Loss on Disposition of Assets                              | 132                       | 4                             |
| Loss on Marketable Securities                              | 7,140                     | --                            |
| Provision for Federal Income Taxes                         | (969)                     | 29,433                        |
| Accrued Interest   | (4,065)                   | --                            |
| <b>DECREASE (INCREASE) IN CURRENT ASSETS:</b>              |                           |                               |
| Accounts Receivable Net                                    | (54,886)                  | 41,683                        |
| Certificates of Deposit Purchased                          | (720,000)                 | --                            |
| Marketable Securities Investments Purchased                | --                        | (12,749)                      |
| Marketable Securities Investments Sold                     | 685,028                   | --                            |
| Inventory  | 17,887                    | (76,822)                      |
| Prepaid Software and Network Services                      | (18,104)                  | --                            |
| Deferred Tax Benefit                                       | 1,600                     |                               |
| Prepaid Expenses   | (13,511)                  | (13,876)                      |



|  |                   |                   |
|--|-------------------|-------------------|
| DECREASE (INCREASE) IN LONG TERM ASSETS:             |                   |                   |
| Prepaid Software and Network Services                | (27,884)          | --                |
| INCREASE (DECREASE) IN CURRENT LIABILITIES:          |                   |                   |
| Accounts Payable and Accrued Expenses                | (59,428)          | (18,347)          |
| Refundable Deposits                                  | 4,037             | (42,666)          |
| Deferred Tax Liability                               | (7,200)           | --                |
| Accrued Federal Income Taxes                         | (20,999)          | 44,817            |
| Deferred Income                                      | --                | <u>(25,088)</u>   |
|  |                   | <u>114,182</u>    |
| <u>(27,715)</u>                                      |                   |                   |
| CASH FLOWS PROVIDED (USED) IN INVESTING ACTIVITIES:  |                   |                   |
| Deposits Applied to Property and Equipment           | --                | 18,605            |
| Additions To Property And Equipment                  | <u>(17,050)</u>   | <u>(35,436)</u>   |
|  |                   | <u>(16,831)</u>   |
| <u>(17,050)</u>                                      |                   |                   |
| CASH FLOWS PROVIDED (USED) IN FINANCING ACTIVITIES:  |                   |                   |
| Cash Distribution Paid to Shareholders               | <u>(51,487)</u>   | <u>(50,987)</u>   |
|  | <u>(51,487)</u>   | <u>(50,987)</u>   |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (96,252)          | 46,364            |
| Cash And Cash Equivalents At Beginning Of Period     | <u>488,480</u>    | <u>378,103</u>    |
|  | <u>\$ 392,228</u> | <u>\$ 424,467</u> |

|   |                   |                   |
|---|-------------------|-------------------|
| Cash And Cash Equivalents At<br>Ending of Period    |                   |                   |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION: |                   |                   |
| Cash Paid Year To Date:                             |                   |                   |
| Interest  | \$ 0              | \$ 0              |
| Federal Income Taxes                                | <u>\$ 39,201</u>  | <u>\$ 0</u>       |
| Cash And Cash Equivalents:                          |                   |                   |
| Cash  | \$ 9,194          | \$ 11,100         |
| Money Market Accounts                               | <u>383,034</u>    | <u>413,367</u>    |
|   | <u>\$ 392,228</u> | <u>\$ 424,467</u> |

(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 10QSB are unaudited and reflect, in the opinion of Management, a fair presentation of operations for the three and nine month periods ended September 30, 2005 and September 30, 2004. Certain information and footnote disclosures 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, 2004 as filed with Securities and Exchange Commission.

The results of operation for the three and nine month periods ended September 30, 2005 and September 30, 2004, are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

**NOTE 2 - INVENTORIES**

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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:

|                  | September 30<br>2005 | December 31<br>2004 |
|------------------|----------------------|---------------------|
| Parts            | \$291,809            | \$ 248,433          |
| Work in progress | 105,758              | 104,488             |
| Finished goods   | <u>189,705</u>       | <u>252,238</u>      |
|                  | <u>\$587,272</u>     | <u>\$ 605,159</u>   |

NOTE 3 EARNINGS (LOSS) PER SHARE

Basic Earnings Per Share (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 5,148,667 and 5,098,667 for the quarters ended September 30, 2005 and 2004 respectively.

| <u>For the Nine Months Ended September 30, 2005</u>           |                               |                                 |                             |
|---|-------------------------------|---------------------------------|-----------------------------|
|   | <u>Income<br/>(Numerator)</u> | <u>Shares<br/>(Denominator)</u> | <u>Per-Share<br/>Amount</u> |
| <u>Basic EPS</u>  | \$86,193                      | 5,148,667                       | <u>\$0.02</u>               |
| Income available to common stockholders                       |                               |                                 |                             |
| <u>Diluted EPS</u>  | \$86,193                      | 5,227,891                       | <u>\$0.02</u>               |
| Income available to common stockholders + assumed conversions |                               |                                 |                             |

NOTE 4 - STOCK OPTIONS

As of September 30, 2005, the Company had outstanding stock options that have been granted periodically to individual employees and directors with no less than three years of continuous tenure with the Company. On February

25, 2005, 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 25, 2005 totaled 195,000 shares under option and have an exercise price of \$0.78 per share. The options granted on February 25, 2005 may be exercised any time during the period from February 25, 2005 through February 25, 2008. The Company's Form 8-K dated February 25, 2005, 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.

During the 12-month period from September 30, 2004 to September 30, 2005, 155,000 shares under option expired, 50,000 shares under option were exercised, and 195,000 shares under option were granted. At September 30, 2005 there were 545,000 shares under option reserved for future exercises.

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation." The Company undertakes to make disclosures and calculations pursuant to SFAS 123 on an annual basis coinciding with the issuance of the Company's Annual Financial Statements. Accordingly, no compensation cost has been recognized for the stock option plan.

#### NOTE 5 - OTHER COMPREHENSIVE INCOME (LOSS)

For the first nine months of 2005, the Company's only item of other comprehensive income (loss) was unrealized losses on marketable securities investments, net of tax in the amount \$2,829. During the same period of 2004, the Company's only item of other comprehensive income (loss) was unrealized losses on marketable securities investments, net of tax in the amount \$2,420.

#### NOTE 6 - RELATED PARTY TRANSACTIONS

For the nine-month period ended September 30, 2005 services in the amount of \$139,543 were contracted with Manufacturing Services, Inc., of which the owner/president is a member of the Board of Directors of the Company.

#### NOTE 7 - CASH DISTRIBUTION

On June 2, 2005, the Company declared a one-time, non-cumulative, cash distribution to shareholders of record as of June 24, 2005, of \$0.01 per share of common stock, with a payable date of July 13, 2005. The payment of the cash distribution totaling \$51,487 was completed by July 13, 2005. The Company's Form 8-K dated June 2, 2005, as filed with the Securities and Exchange Commission is included herein by reference.

## ITEM II

### 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 September 30, 2005. 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 systems, accessories, and services increased to \$650,195 for the third quarter of 2005 as compared to \$457,485 in the third quarter of 2004, reflecting an increase of 42% from the previous year's quarter. Gross revenues increased to \$661,454 for the quarter ending September 30, 2005, from \$463,482 for the third quarter of 2004, reflecting an increase of 43% from the previous year. Management believes the increase in sales revenue is due to strong domestic and foreign export Industrial Automation product sales for the quarter when compared with relatively soft performance from these market segments during the same quarter of 2004. Management believes the increase in foreign export sales is the result of the comparatively strong third quarter 2005 sales into the countries of Colombia, Croatia and Canada for Industrial Automation projects, when compared with the third quarter of 2004. Management is of the opinion that domestic sales increased due to strong sales of the Company's ESTeem 195Eg Ethernet modem product and related accessories for Ethernet based Industrial Automation projects when compared with the same quarter of 2004.

As of September 30, 2005, revenues from the sale of the Company's products and services decreased to \$1,780,378 for the first nine months of 2005, as compared to \$1,789,944 for the same period of 2004. Management believes the decrease in revenues year-to-date, is the result of increased product and price competition in the industrial automation market, which negatively impacted revenues during 2004 and the first half of 2005. Notwithstanding third quarter results, Management is cautious that 2005 sales revenues as a whole will be negatively impacted by these competitive and economic factors. The Company continues to counter these competitive and economic factors by increasing salesperson activity to enhance relationships with resellers of the Company's products and to maintain tradeshow attendance specifically targeted to markets of the Company's products.

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.

The Company's revenues fall into four major customer categories, Domestic, Export, Mobile Data Computer (MDCS) and U.S. Government Sales. Domestic commercial sales increased to \$376,546 in the third quarter of 2005 as compared to \$295,566 for the third quarter of 2004. Foreign export sales for the third quarter of 2005 increased to \$180,282 as compared to the \$80,441 in the same quarter of 2004, due to strong sales to Colombia, Croatia and Canada when compared with the same period of 2004.

MDCS sales for public safety entities increased to \$81,710 in the third quarter of 2005, as compared to \$66,651 for the same period of 2004. In September 2005, the Company received a commitment from Mississippi State Highway Patrol to purchase MDCS related products of approximately \$210,000 through a reseller of the Company's products. As of September 30, 2005, the Company had completed delivery of \$30,000 in products for this project, and expects to complete delivery by the end of the first quarter of 2006. However completion is dependent upon order release from the reseller and integration scheduling on the part of the Mississippi State Highway Patrol. U.S. Government sales decreased slightly to \$11,657 in the third quarter of 2005, from third quarter 2004 levels of \$14,827. Due to the uncertain nature of U.S. Government purchasing, Management does not base profitability or liquidity projections on expected U.S. Government sales.

No sale to a single customer comprised 10% or more of the Company's product and service sales for the quarter ending September 30, 2005.

A percentage breakdown of EST's major customer categories of Domestic, Export and U.S. Government Sales, for the third quarter of 2005 and 2004 is as follows:

| For the third quarter of   |             |             |
|----------------------------|-------------|-------------|
|                            | <u>2005</u> | <u>2004</u> |
| Domestic Sales             | 58%         | 64%         |
| Export Sales               | 28%         | 18%         |
| Mobile Data Computer Sales | 12%         | 15%         |
| U.S. Government Sales      | 2%          | 3%          |

A percentage breakdown of EST's product sales categories for the third quarter of 2005 and 2004 are as follows:

| For the Quarter Ended September 30                                  |             |             |
|---|-------------|-------------|
|   | <u>2005</u> | <u>2004</u> |
| ESTeem Model 192 (Licensed and non-Ethernet Spread Spectrum Modems) | 39%         | 48%         |
| ESTeem Model 192E and 195Eg (Ethernet Modems)                       | 42%         | 26%         |
| ESTeem Accessories  | 13%         | 18%         |
| Factory Services  | 2%          | 2%          |
| Site Support  | 4%          | 6%          |

Sales for the third quarter of 2005 and 2004 include foreign export sales as follows:

| Three Months Ended | <u>September 30, 2005</u> | <u>September 30, 2004</u> |
|--------------------|---------------------------|---------------------------|
| Export sales       | \$ 180,282                | \$ 80,442                 |
| Percent of sales   | 28%                       | 18%                       |

The geographic distribution of foreign sales for the third quarter of 2005 and 2004 is as follows:

| Percent of Foreign Sales |                           |                           |
|--------------------------|---------------------------|---------------------------|
| <u>COUNTRY</u>           | <u>September 30, 2005</u> | <u>September 30, 2004</u> |
| Colombia                 | 25%                       | --                        |
| Canada                   | 18%                       | 42%                       |

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|             |     |     |
|-------------|-----|-----|
| Croatia     | 17% | --  |
| Mexico      | 15% | 12% |
| Chile       | 11% | 9%  |
| Puerto Rico | 5%  | Nil |
| Peru        | 5%  | 10% |
| Singapore   | 2%  | --  |
| Jordan      | 2%  | --  |
| Brazil      | Nil | 15% |
| Ecuador     | --  | 10% |
| Egypt       | --  | 2%  |

The majority of the Company's domestic and foreign sales for the third quarter of 2005 were used in Industrial Automation applications

It is Management's opinion that the majority of the Company's sales will continue to be in Industrial Automation applications for the foreseeable future. Industrial Automation applications for the Company's products will be augmented by sales of MDCS for public safety entities. During the third quarter of 2005, MDCS sales accounted for 12% of the Company's sales and service revenues.

**BACKLOG:**

The Company had a backlog of \$198,400 at September 30, 2005, which was comprised of orders placed late in September and ongoing MDCS projects. 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 percentages of gross sales for the third quarters of 2005 and 2004 were 43% and 48%, respectively. The cost of sales decrease during the third quarter of 2005 is the result a favorable change in product mix of items sold and pricing discounts on those products, when compared with the same period of 2004.

**OPERATING EXPENSES:**

Operating expenses for the third quarter of 2005 increased \$15,539 when compared with the third quarter of 2004. The following is a delineation of operating expenses:

|                        |                              |                              |                            |
|------------------------|------------------------------|------------------------------|----------------------------|
| For the quarter ended: | September 30,<br><u>2005</u> | September 30,<br><u>2004</u> | <u>Increase (Decrease)</u> |
|------------------------|------------------------------|------------------------------|----------------------------|

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|                          |                   |                   |                  |
|--------------------------|-------------------|-------------------|------------------|
| Finance/Administration   | \$ 43,044         | \$ 40,379         | \$ 2,665         |
| Research/Development     | 66,934            | 85,858            | (18,924)         |
| Marketing                | 129,057           | 94,702            | 34,355           |
| Customer Service         | <u>22,324</u>     | <u>24,882</u>     | <u>(2,558)</u>   |
| Total Operating Expenses | <u>\$ 261,359</u> | <u>\$ 245,821</u> | <u>\$ 15,538</u> |

**FINANCE AND ADMINISTRATION:**

During the third quarter of 2005 Finance and Administration expenses increased to \$43,044 when compared with the third quarter of 2004. The increase is the result of increased professional services required by the Company for government compliance and administration when compared the same quarter of 2004.

**RESEARCH AND DEVELOPMENT:**

During the third quarter of 2005, Research and Development expenses decreased \$18,924 when compared with the third quarter of 2004. The decrease is the result of decreased subcontracted engineering expertise and development related material when compared with the same quarter of 2004, which had strong development activity for the ESTeem 195Eg product.

**MARKETING:**

Marketing expenses increased \$34,355 during the third quarter of 2005 when compared with the third quarter of 2004 due to increased department related salaries, travel and tradeshow expenses. The increase is due to the hiring of an additional sales manager during 2005, increased sales related travel and increased tradeshow attendance by the Company during the third quarter of 2005.

**CUSTOMER SERVICE:**

Customer service expenses for the third quarter of 2005 decreased \$2,558 when compared with the third quarter of 2004. The decrease is due to decreased department related travel expenses, and increased proportion of department costs being billed directly to customers for engineering services when compared with the same quarter of 2004.

**INTEREST AND INVESTMENT INCOME:**

The Company earned \$11,259 in investment and interest income for the quarter ended September 30, 2005. Sources of this income were money market accounts, certificates of deposit and marketable securities investments.

**NET INCOME (LOSS):**

The Company recorded a net income of \$80,947 for the third quarter of 2005, compared to a net loss of \$3,536 for the third quarter of 2004. The increase is the result of increased sales revenues during the third quarter of 2005 when compared with the third quarter of 2004. Year to date, the Company has net income of \$86,193 for the nine months ended September 30, 2005, compared with \$144,151 for the same period of 2004. The decreased year to date net income is the result of decreased sales revenues and increased operating expenses negatively effecting year to date profitability when compared with the same period of 2004.



## B. Financial Condition, Liquidity and Capital Resources

The Corporation's current asset to current liabilities ratio at September 30, 2005 was 15.5:1 compared to 13:1 at December 31, 2004. The increase in current ratio is due to decreased accounts payable liabilities as of September 30, 2005 when compared with December 31, 2004 amounts. Management views that this trend is likely to continue for the year as a whole.

For the quarter ending September 30, 2005, the Company had cash and cash equivalent holdings of \$392,228 as compared to cash and cash equivalent holdings of \$488,480 at December 31, 2004. Available for sale marketable securities decreased to \$925,934 compared to \$1,344,619 at December 31, 2004 as the result of restructuring of the Company's investments to include certificates of deposit. The Company had certificates of deposit investments in the amount of \$449,370 as of September 30, 2005. Certain components of investments held by the Company, if sold as of September 30, 2005, would have presented a realized loss net of tax, of \$13,940, compared with a potential loss net of tax, of \$15,824 as of December 31, 2004. The contingency for these items is reflected in the Balance Sheets as Accumulated Other Comprehensive Gain (Loss), and the Statements of Comprehensive Income (Loss), respectively, as of September 30, 2005.

Accounts receivable increased to \$311,966 as of September 30, 2005, from December 31, 2004 levels of \$257,080, due to strong late third quarter 2005 sales activity. Inventory decreased to \$587,272 at September 30, 2005, from December 31, 2004 levels of \$605,159, due to increased product sales during the third quarter of 2005. The Company's fixed assets, net of depreciation, decreased to \$217,196 as of September 30, 2005, from December 31, 2004 levels of \$253,456

due to capital expenditures of \$17,050 for fixed assets and being offset by depreciation of \$53,178, and loss on asset disposition of \$132. Prepaid expenses increased to \$26,089 as of September 30, 2005 from December 31, 2004 amounts of \$12,578 due to recent renewal of annual insurance policies and increased prepaid tradeshow expenses.

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 September 30, 2005, is reflected as prepaid software/network services and amounted to \$18,104. The long-term portion of the prepaid Netsuite Inc. services as of September 30, 2005 is reflected as prepaid software/network services and is classified a long-term asset for the Company.

As of September 30, 2005, the Company's trade accounts payable balance was \$68,827 as compared with \$96,949 at December 31, 2004, and reflects amounts owed for purchases of inventory items, contracted services and capital expenditures. Refundable deposit liability was \$7,667 for the quarter ended September 30, 2005, and reflects prepaid amounts for foreign export orders received in late September 2005. Accrued liabilities as of September 30, 2005 were \$37,949, compared with \$69,255 at December 31, 2004, and reflect items such as accrued vacation benefits, and quarterly payroll and excise tax liabilities.

Federal Income Taxes payable increased to \$60,200 as of September 30, 2005 as a result of the Company's year-to-date profitability and estimated tax liabilities.

It is Management's opinion the Company's cash, cash equivalent reserves, and working capital at September 30, 2005 are sufficient to satisfy requirements for operations, capital expenditures, and other expenditures as may arise in the short term.

### 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 III  
CONTROLS & PROCEDURES

**a. Evaluation of Disclosure Controls and Procedures.**

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 September 30, 2005. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures are reasonably designed and effective to ensure that (i) information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

• **Changes in Internal Controls.**

There were no significant changes in the Company's internal controls or in other factors that could significantly affect the Company's disclosure controls and procedures subsequent to the Evaluation Date, nor any significant deficiencies or material weaknesses in such disclosure controls and procedures requiring corrective actions.

PART II  
OTHER INFORMATION

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

|     |                     |
|-----|---------------------|
| (b) | Reports on Form 8-K |
|-----|---------------------|

Form 8-K dated February 25, 2005 is incorporated herein by reference.

Form 8-K dated June 2, 2005 is incorporated herein by reference.

|                |  |
|----------------|--|
| Exhibit Number | Notes to Financial Statements  |
| <b>4.</b>      | <b>Instruments defining the Rights of Security Holders including indentures.</b> |

Form 8-K dated February 25, 2005 is incorporated herein by reference.

|            |   |
|------------|---|
| <b>11.</b> | <b>Statement Re: computation of per share earnings.</b> |
|------------|---|

Note 3 to Financial Statements

31.1 CEO Certification

31.2 CEO 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: November 7, 2005 | /s/ T.L. KIRCHNER                               |
|                        | Name: T.L. Kirchner                             |
|                        | Title: Director/President                       |
|                        | (Principal Executive Officer)                   |
| Date: November 7, 2005 | /s/ JON CORREIO                                 |
|                        | Name: Jon Correio                               |
|                        | Title: Vice President, Finance & Administration |
|                        | (Principal Financial Officer)                   |

