

ELECTRONIC SYSTEMS TECHNOLOGY INC
Form 10-Q
May 08, 2014

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

FORM 10-Q

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

For the quarterly period ended **March 31, 2014**

OR

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

From _____ to _____

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

Washington
(State or other jurisdiction of incorporation)

000-27793
(Commission File
Number)

91-1238077
(IRS Employer Identification No.)

415 N. Quay St. Bldg B1 Kennewick WA
(Address of principal executive offices)

99336
(Zip Code)

(509) 735-9092

(Registrant's telephone number, including area code)

N/A

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every

Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES x NO ..

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

Large accelerated filer

..

Accelerated filer

..

Non-accelerated filer

.. (Do not check if a smaller reporting company)

Smaller reporting company

x

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

As of April 22, 2014, the number of the Company's shares of common stock par value \$0.001, outstanding was 5,158,667.

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PART I - FINANCIAL INFORMATION

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

SELECTED FINANCIAL DATA

(as prepared by Management)

(Unaudited)

| | | |
|----------------------------------------------|----------------------------------------|---------------|
| Three Months Ended | Mar. 31, 2014 | Mar. 31, 2013 |
| Sales and Site Support Income | \$ 499,824 | \$ 413,413 |
| Other revenues | \$ 2,549 | \$ 1,989 |
| Gross profit | \$ 271,882 | \$ 223,699 |
| Net income (loss) before taxes | \$ (6,190) | \$ (64,373) |
| Net income (loss) | \$ (5,950) | \$ (45,612) |
| | Earnings (loss) per share before taxes | |
| Basic | Nil | \$ (0.01) |
| Diluted | Nil | \$ (0.01) |
| | Earnings (loss) per share | |
| Basic | Nil | \$ (0.01) |
| Diluted | Nil | \$ (0.01) |
| | Weighted average shares outstanding | |
| Basic | 5,158,667 | 5,158,667 |
| Diluted | 5,158,667 | 5,158,667 |
| Total assets | \$ 3,117,156 | \$ 2,998,210 |
| Long-term debt and capital lease obligations | \$ - | \$ - |
| Shareholders' equity | \$ 3,056,028 | \$ 2,897,924 |
| Shareholders' equity per share | \$ 0.59 | \$ 0.56 |
| Working capital | \$ 2,983,642 | \$ 2,826,451 |
| Current ratio | 57.8:1 | 31:1 |
| Equity to total assets | 98 % | 97 % |

Item 1. Financial Statements.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

BALANCE SHEETS

(as prepared by Management)

| | Mar. 31, 2014 | Dec. 31, 2013 |
|----------------------------------------------------------|---------------|---------------|
| | (Unaudited) | |
| <u>ASSETS</u> | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 681,952 | \$ 896,581 |
| Short term certificates of deposit | 1,409,000 | 1,414,000 |
| Accounts receivable, net of allowance for uncollectibles | 199,612 | 72,783 |
| Inventories | 720,664 | 625,692 |
| Accrued interest receivable | 3,863 | 2,948 |
| Prepaid insurance | 6,883 | 11,389 |
| Prepaid expenses | 14,196 | 24,296 |
| Total current assets | 3,036,170 | 3,047,689 |
| | | |
| PROPERTY & EQUIPMENT net of depreciation | 39,711 | 31,372 |
| | | |
| DEPOSITS | 1,675 | 13,083 |
| DEFERRED INCOME TAX ASSET | 39,600 | 36,600 |
| TOTAL ASSETS | \$ 3,117,156 | \$ 3,128,744 |
| | | |
| <u>LIABILITIES & STOCKHOLDERS' EQUITY</u> | | |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 9,614 | \$ 8,669 |
| Refundable deposits | 1,940 | 4,910 |
| Accrued liabilities | 40,974 | 50,332 |
| Total current liabilities | 52,528 | 63,911 |
| | | |
| DEFERRED INCOME TAX LIABILITY | 8,600 | 5,100 |
| TOTAL LIABILITIES | 61,128 | 69,011 |

STOCKHOLDERS' EQUITY

Common stock, \$0.001 par value 50,000,000 shares

| | | |
|--------------------------------------------|--------------|--------------|
| authorized 5,158,667 shares issued | 5,159 | 5,159 |
| Additional paid-in capital | 1,007,861 | 1,005,616 |
| Retained earnings | 2,043,008 | 2,048,958 |
| Total stockholders' equity | 3,056,028 | 3,059,733 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 3,117,156 | \$ 3,128,744 |

See Notes to Financial Statements

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

STATEMENTS OF OPERATIONS

(as prepared by Management)

(Unaudited)

| Three Months Ended | Mar. 31, 2014 | Mar. 31, 2013 |
|--------------------------------------------------------|---------------|---------------|
| SALES, net | \$ 448,809 | \$ 400,357 |
| SITE SUPPORT | 51,015 | 13,056 |
| COST OF SALES | (227,942) | (189,714) |
| GROSS PROFIT | 271,882 | 223,699 |
| OPERATING EXPENSES | | |
| General and administrative | 86,200 | 88,292 |
| Research and development | 58,849 | 56,805 |
| Marketing | 108,240 | 115,863 |
| Customer service | 27,331 | 29,101 |
| Total operating expenses | 280,621 | 290,061 |
| OPERATING LOSS | (8,739) | (66,362) |
| OTHER INCOME | | |
| Interest income | 2,549 | 1,989 |
| Total other income | 2,549 | 1,989 |
| NET LOSS BEFORE INCOME TAX | (6,190) | (64,373) |
| INCOME TAX BENEFIT | 240 | 18,761 |
| NET LOSS | \$ (5,950) | \$ (45,612) |
| BASIC LOSS PER SHARE | \$ Nil | \$ (0.01) |
| DILUTED LOSS PER SHARE | \$ Nil | \$ (0.01) |
| OUTSTANDING BASIC & DILUTED WEIGHTED AVERAGE SHARES | 5,158,667 | 5,158,667 |

See Notes to Financial Statements

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

STATEMENTS OF CASH FLOWS

(as prepared by Management)

(Unaudited)

| Three Months Ended | Mar. 31, 2014 | Mar. 31, 2013 |
|---------------------------------------------------------------|-------------------|-------------------|
| CASH FLOWS PROVIDED (USED) IN OPERATING ACTIVITIES: | | |
| Net loss | \$ (5,950) | \$ (45,612) |
| Noncash items included in loss: | | |
| Depreciation | 2,531 | 3,274 |
| Deferred income taxes | 500 | (11,000) |
| Share based compensation | 2,245 | 1,713 |
| DECREASE (INCREASE) IN OPERATING ASSETS: | | |
| Accounts receivable, net | (126,829) | 110,250 |
| Inventories | (94,972) | (40,893) |
| Accrued interest receivable | (915) | (1,443) |
| Prepaid insurance | 4,506 | 2,875 |
| Prepaid expenses | 10,101 | 5,780 |
| Deposits | 11,408 | -- |
| INCREASE (DECREASE) IN OPERATING LIABILITIES: | | |
| Accounts payable | 945 | 6,301 |
| Refundable deposits | (2,970) | 38,281 |
| Accrued liabilities | (9,359) | 3,904 |
| NET CASH FLOWS PROVIDED (USED) IN OPERATING ACTIVITIES | (208,759) | 73,430 |
| CASH FLOWS PROVIDED (USED) IN INVESTING ACTIVITIES: | | |
| Certificates of deposit redeemed (purchased) | 5,000 | (134,000) |
| Purchase of equipment | (10,870) | -- |
| NET CASH FLOWS PROVIDED (USED) IN INVESTING ACTIVITIES | (5,870) | (134,000) |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (214,629) | (60,570) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 896,581 | 818,497 |
| CASH AND CASH EQUIVALENTS AT ENDING OF PERIOD | \$ 681,952 | \$ 757,927 |
| Cash and cash equivalents: | | |

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| | | | | |
|---------------------------------|----|---------|----|---------|
| Cash | \$ | 50,158 | \$ | 123,532 |
| Money market accounts | | 631,794 | | 634,395 |
| Total cash and cash equivalents | \$ | 681,952 | \$ | 757,927 |

See Notes to Financial Statements

NOTE 1 - BASIS OF PRESENTATION

The financial statements of Electronic Systems Technology, Inc. (the "Company") presented in this Form 10Q are unaudited and reflect, in the opinion of Management, a fair presentation of operations for the three month periods ended March 31, 2014 and March 31, 2013. All adjustments of a normal recurring nature and necessary for a fair presentation of the results for the periods covered have been made. Certain information and footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the applicable rules and regulations of the Securities and Exchange Commission. In preparation of the financial statements, certain amounts and balances have been reformatted from previously filed reports to conform to the format of this quarterly presentation. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Form 10K for the year ended December 31, 2013 as filed with Securities and Exchange Commission.

The results of operations for the three-month period ended March 31, 2014 are not necessarily indicative of the results expected for the full fiscal year or for any other fiscal period.

NOTE 2 - INVENTORIES

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

| | March 31 2014 | December 31 2013 |
|------------------|---------------|---------------------|
| Parts | \$300,550 | \$217,567 |
| Work in progress | 68,224 | 83,620 |
| Finished goods | 351,890 | 324,505 |
| Total inventory | \$720,664 | \$625,692 |

NOTE 3 - EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share excludes dilution and is computed by dividing income (loss) available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings (loss) per share 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. At March 31, 2014 the Company had 515,000 outstanding stock options that could have a dilutive effect on future periods' income.

NOTE 4 - STOCK OPTIONS

As of March 31, 2014, the Company had outstanding stock options, which have been granted periodically to individual employees and directors with no less than three years of continuous tenure with the Company. On February 28, 2014, 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 28, 2014 totaled 175,000 shares under option and have an exercise price of \$0.41 per share.

The options granted on February 28, 2014 vest immediately and may be exercised any time during the period from February 28, 2014 through February 28, 2017. 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:

| | 2014 | 2013 | 2012 | 2011 |
|-------------------------------|--------|--------|--------|--------|
| Dividend yield | 0.00% | 0.00% | 0.00% | 0.00% |
| Expected volatility | 75% | 73% | 68% | 74% |
| Risk-free interest rate | 0.68% | 0.38% | 0.36% | 1.40% |
| Expected term (in years) | 3 | 3 | 3 | 3 |
| Fair Value per Option Granted | \$0.20 | \$0.15 | \$0.15 | \$0.21 |

The Company uses historical data to estimate option exercise rates. The option exercise rate for option grants in 2013 through 2005 was 6.43%.

A summary of option activity during the quarter ended March 31, 2014, is as follows:

| | Number Outstanding | Weighted-Average Exercise Price Per Share |
|--------------------------------------------------|--------------------|-------------------------------------------|
| Outstanding and Exercisable at December 31, 2013 | 525,000 | \$0.38 |
| Granted | 175,000 | 0.41 |
| Expired | (185,000) | 0.44 |
| Outstanding and Exercisable at March 31, 2014 | 515,000 | \$0.40 |

During the first quarter of 2014, the Company issued 175,000 options with an estimated fair value per option of \$0.20 resulting in a stock based compensation value of \$34,930. After the stock based compensation value is adjusted for the historical option forfeiture rate of 93.6%, a stock based compensation expense was charged against income for the first quarter of 2014 of \$2,245. No non-vested share-based compensation arrangements existed as of March 31, 2014. At March 31, 2014 the intrinsic value of outstanding stock options was approximately \$10,300.

NOTE 5 - RELATED PARTY TRANSACTIONS

For the quarters ended March 31, 2014 and March 31, 2013, services in the amount of \$19,156 and \$20,884, respectively, were contracted with Manufacturing Services, Inc., of which the current owner, Michael S. Brown and the former owner, Melvin H. Brown, are both currently members of the Company's Board of Directors. The Company had accounts payable to Manufacturing Services, Inc at March 31, 2014 and March 31, 2013 of \$180 and \$1,498,

respectively.

NOTE 6 - SEGMENT REPORTING

Segment information is prepared on the same basis that the Company's management reviews financial information for operational decision making purposes. The Company has three reportable segments, domestic and foreign, based on the geographic location of the customers, as well as an unallocated corporate segment. Domestic and foreign segments sell radio modem products, related accessories for radio modem products for industrial automation projects, with the foreign segment selling the Company's products and services outside the United States.

During the quarters ended March 31, 2014 and 2013, domestic customers represented approximately 81% and 65% of total net revenues, respectively. In addition during the quarters ended March 31, 2014 and 2013, foreign customers represented 19% and 35% of total net revenues, respectively. During the quarter ended March 31, 2014, product sales to two customers exceeded more than 10% of the Company's sales revenues which were customer A was 10.8% of net revenue; and customer B was 10.8% of net revenue. During the quarter ended March 31, 2013 one customer accounted for 12% of the Company's revenues.

Revenues from foreign countries consisted primarily of revenues from Croatia, Peru, and Bolivia.

Summary financial information for the three reportable segments for the first quarter of 2014 and 2013 is as follows:

| | | | Unallocated | |
|--------------------------------------------|-----------|-----------|-------------|-----------|
| | Domestic | Foreign | Corporate | Total |
| <u>Quarter ended March 31, 2014</u> | | | | |
| Total sales | \$405,170 | \$94,654 | \$ - | \$499,824 |
| Total other income | - | - | 2,549 | 2,549 |
| Earnings (loss) before tax | 56,372 | 21,090 | (83,652) | (6,190) |
| Depreciation/amortization | 1,820 | - | 711 | 2,531 |
| Identifiable assets | 235,053 | 6,398 | 2,877,905 | 3,117,156 |
| Net capital expenditures | | | 10,870 | 10,870 |
| <u>Quarter ended March 31, 2013</u> | | | | |
| Total sales | \$267,833 | \$145,580 | \$ - | \$413,413 |
| Total other income | - | - | 1,989 | 1,989 |
| Earnings (loss) before tax | (15,276) | 37,205 | (86,302) | (64,373) |
| Depreciation/amortization | 2,605 | - | 669 | 3,274 |
| Identifiable assets | 624,356 | 17,960 | 2,355,894 | 2,998,210 |

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

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

Management's discussion and analysis is intended to be read in conjunction with the Company's unaudited financial statements and the integral notes thereto for the quarter ended March 31, 2013. The following statements may be forward looking in nature and actual results may differ materially.

A.

RESULTS OF OPERATIONS

REVENUES: Total revenues from sales increased to \$499,824 for the first quarter of 2014 as compared to \$413,413 in the first quarter of 2013, reflecting an increase of 21%. Gross revenues, including interest income, increased to \$502,373 for the quarter ended March 31, 2014, from \$415,402 for the same quarter of 2013. Management believes the increase in sales revenues is due to increased domestic industrial automation sales during first quarter of 2014 when compared with the same quarter of 2013. Management remains concerned that the fragile economic recovery in Latin America has the potential to negatively impact domestic sales revenues and profitability during 2014.

The Company's revenues have historically fluctuated from quarter to quarter due to timing factors such as product shipments to customers, customer order placement, 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 with regard to the Company's revenues are difficult to predict.

A percentage breakdown of EST's market segments of Domestic and Foreign Export sales, for the first quarter of 2014 and 2013 are as follows:

| For the first quarter of | 2014 | 2013 |
|--------------------------|------|------|
|--------------------------|------|------|

| | | |
|----------------|-----|-----|
| Domestic Sales | 81% | 65% |
| Export Sales | 19% | 35% |

OPERATING SEGMENTS

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

Domestic Revenues

The Company's domestic operations represented 81% of the Company's total sales revenues. Domestic operations sell ESTeem modem products, accessories and service primarily through domestic resellers, as well as directly to end users of the Company's products. Domestic sales revenues increased to \$405,170 for the quarter ended March 31, 2014, compared to \$267,833 for the quarter ended March 31, 2013, reflecting an increase of 51%. During the quarter ended March 31, 2014, product sales to two customers, comprised 22% of the Company's sales revenues. Management believes the increase in domestic sales revenues is the result of the increased demand for the Company's products for domestic industrial.

Domestic segment operating profit was \$56,372 for the quarter ended March 31, 2014 as compared with a domestic segment operating loss of \$15,276 for the same quarter of 2013, due to increased sales revenues for the segment during the first quarter of 2014.

Foreign Revenues

The Company's foreign operating segment represented 19% of the Company's total net revenues for the quarter ended March 31, 2014. 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 March 31, 2014, the Company had \$94,654 in foreign export sales, or 19% of total net revenues of the Company for the quarter, compared with foreign export sales of \$145,580 or 35% of net revenues for the same quarter of 2013, reflecting a decrease of 35%. The majority of foreign export sales revenues during the first quarter of 2014 were used in industrial automation projects in Croatia, Peru and Bolivia. Management believes the decrease in foreign sales revenues is due to decreased product sales for industrial automation sales in Latin America during the first quarter of 2014 due to the weak economic recover in Latin America. 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 decreased to \$21,090 for the quarter ended March 31, 2014 as compared with \$37,205 for the same period of 2013 due to decreased sales revenues for the quarter ended March 31, 2013.

Unallocated Corporate

Unallocated corporate expenses relate to functions, such as accounting, corporate management and administration that support but are not attributable to the Company's domestic or foreign operating segments, including salaries, wages and other expenses related to the performance of these support functions. Unallocated corporate expenses decreased during the quarter ended March 31, 2014 to \$83,652 as compared with \$86,302 for the same quarter of 2013.

Unallocated corporate expenses represented expense to total sales percentage of 17% and 21% for the first quarter of 2014 and 2013, respectively.

BACKLOG:

As of March 31, 2014, the Company had a sales order backlog of \$27,873. 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 percentages for the first quarters of 2014 and 2013 were 41% and 46% of gross sales respectively. The cost of sales percentage increase in the first quarter of 2014 is the result of the product mix of items and services sold during the quarter having decreased profit margins when compared with the product mix sold during the same quarter of 2013.

OPERATING EXPENSES:

Operating expenses for the first quarter of 2014 decreased \$9,440 from first quarter of 2013 levels. The following is a delineation of operating expenses:

| | March 31 | March 31 | Increase |
|----------------------------|------------|------------|------------|
| | 2014 | 2013 | (Decrease) |
| General and administrative | \$ 86,200 | \$ 88,292 | \$ (2,091) |
| Research and development | 58,849 | 56,805 | 2,044 |
| Marketing | 108,240 | 115,863 | (7,623) |
| Customer service | 27,331 | 29,101 | (1,770) |
| Total operating expenses | \$ 280,621 | \$ 290,061 | \$ (9,440) |

General and administrative: For the first quarter of 2014 General and administrative expenses decreased \$2,091 to \$86,200, due to slightly decreased benefit expenses when compared with the same quarter of 2013.

Research and development: Research and Development expenses increased \$2,044 to \$58,849, during the first quarter of 2014, due to increased development related costs when compared with the same quarter of 2013.

Marketing: During the first quarter of 2014, marketing expenses decreased \$7,623 to \$108,240 when compared with the same period of 2013, due to decreased department travel expenses during the first quarter of 2014.

Customer service: Customer service expenses decreased \$1,770 to \$27,331 during the first quarter of 2014, due to decreased amount of department related travel expenses.

INTEREST AND DIVIDEND INCOME:

The Corporation earned \$2,549 in interest and dividend income during the quarter ended March 31, 2014. Sources of this income were money market accounts and certificates of deposit.

NET INCOME (LOSS):

The Company had a net loss of \$5,950 for the first quarter of 2014 compared to a net loss of \$45,612 for the same quarter of 2013. The decrease in net loss during 2014 is the result of increased sales revenues, product mix and reduced expenses.

B.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

The Corporation's current asset to current liabilities ratio at March 31, 2014 was 57.8:1 compared to 47.7:1 at December 31, 2013. The increase in current ratio is due to increased accounts receivable and inventory at March 31, 2014 when compared with December 31, 2013.

For the quarter ended March 31, 2014, the Company had cash and cash equivalents of \$681,952 as compared to cash and cash equivalent holdings of \$896,581 at December 31, 2013, primarily reflecting changes in inventory and Accounts Receivable when compared with year-end 2013.

Accounts receivable increased to \$199,612 as of March 31, 2014, from December 31, 2013 levels of \$72,783 due to sales and collection timing differences when compared with year-end 2013. Inventory increased to \$720,664 at March 31, 2014 from December 31, 2013 levels of \$625,692. The Company's fixed assets, net of depreciation, increased to \$39,711 as of March 31, 2014 from December 31, 2013 levels of \$31,372, due to purchase of equipment during the first quarter of 2014 of \$10,870. Deferred tax asset as of March 31, 2014 increased to \$39,600 due to the income tax benefit recognized during the first quarter of 2014. Prepaid insurance and expenses decreased to \$21,079 as of March 31, 2014 as compared with \$35,685 for December 31, 2013 due to reduced prepaid network and insurance expenses when compared with year-end 2013.

As of March 31, 2014, the trade accounts payable balance was \$9,614 compared with \$8,669 at December 31, 2013, and reflect amounts owed for purchases of inventory items and contracted services. Accrued liabilities as of March 31, 2014 were \$40,974, compared with \$50,332 at December 31, 2013, and reflect items such as payroll and state tax liabilities and accrued vacation benefits. At March 31, 2014 the Company had refundable customer deposit liabilities of \$1,940.

In Management's opinion, the Company's cash and cash equivalent reserves, and working capital at March 31, 2014 is sufficient to satisfy requirements for operations, capital expenditures, and other expenditures as may arise during 2014.

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There is no established market for trading the common stock of the Company. The market for the Company's common stock is limited, and as such shareholders may have difficulty reselling their shares when desired or at attractive market prices. The Common Stock is not regularly quoted in the automated quotation system of a registered securities system or association. Our common stock, par value \$0.001 per share, is quoted on the OTC Markets Group QB (OTCQB) under the symbol ELST. The OTCQB is a network of security dealers who buy and sell stock. The dealers are connected by a computer network which provides information on current bids and asks as well as volume information. The OTCQB is not considered a national exchange. The over-the-counter quotations do not reflect inter-dealer prices, retail mark-ups commissions or actual transactions. The Company's common stock has continued to trade in low volumes and at low prices. Some investors view low-priced stocks as unduly speculative and therefore not appropriate candidates for investment. Many institutional investors have internal policies prohibiting the purchase or maintenance of positions in low-priced stocks.

Item 4. Controls and Procedures.

The Company's Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. The Company's internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements; providing reasonable assurance that receipts and expenditures of Company assets are made in accordance with Management authorization; and providing reasonable assurance that unauthorized acquisition, use or disposition of Company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

An evaluation has been performed under the supervision and with the participation of our Management, including our Chief Executive Officer and Principal Accounting 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 March 31, 2014. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have determined that there was a material weakness affecting our internal control over financial reporting and, as a result of that weakness, our disclosure controls and procedures were not effective as of March 31, 2014.

The material weakness is as follows:

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

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

Changes in internal control over financial reporting.

There have been no changes during the quarter ended March 31, 2014 in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, internal controls over financial reporting.

PART II OTHER INFORMATION

Item 5. Other Information

None

Item 6. Exhibits

| E X H I B I T NUMBER | DESCRIPTION |
|-------------------------|--------------------------------------------------------|
| 31.1 | <u>Section 302 Certification, CEO</u> |
| 31.2 | <u>Section 302 Certification, CFO</u> |
| 32.1 | <u>Section 906 Certification, CEO</u> |
| 32.2 | <u>Section 906 Certification, CFO</u> |
| 101.INS ⁽¹⁾ | XBRL Instance Document |
| 101.SCH ⁽¹⁾ | XBRL Taxonomy Extension Schema Document |
| 101.CAL ⁽¹⁾ | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF ⁽¹⁾ | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB ⁽¹⁾ | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE ⁽¹⁾ | XBRL Taxonomy Extension Presentation Linkbase Document |

(1)

Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Act of 1934 and otherwise are not subject to liability.

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: May 7, 2014
By: /s/ T. L. KIRCHNER
Name: T.L. Kirchner
Title: Director/President
(Principal Executive Officer)

Date: May 7, 2014
By: /s/ Michael W. Eller
Name: Michael W. Eller
Title: Manager of Finance & Admin
(Principal Accounting Officer)