RAYONIER INC
Form 10-Q
May 07, 2010
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# UNITED STATES

## SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2010

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ________ to ________

COMMISSION FILE NUMBER 1-6780

# RAYONIER INC.

**Incorporated in the State of North Carolina**

**I.R.S. Employer Identification Number 13-2607329**

**50 North Laura Street, Jacksonville, FL 32202**

**(Principal Executive Office)**

**Telephone Number: (904) 357-9100**

Indicate by check mark whether the registrant (l) has filed all reports required to be filed by Section l3 or l5(d) of the Securities Exchange Act of l934 during the preceding l2 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 ¨

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES ¨ NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer | x | Accelerated filer | ¨ |
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | Smaller reporting company | ¨ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES ¨ NO x

As of May 3, 2010, there were outstanding 80,182,860 Common Shares of the Registrant.

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**PART I. FINANCIAL INFORMATION**

**Item1. Financial Statements**

**RAYONIER INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

**AND COMPREHENSIVE INCOME**

**(Unaudited)**

**(Dollars in thousands, except per share data)**

| | Three Months Ended March 31, 2010 | 2009 |
|---|---|---|
| **SALES** | $ 310,200 | $ 279,385 |
| Costs and Expenses | | |
| Cost of sales | 232,853 | 224,347 |
| Selling and general expenses | 16,967 | 14,642 |
| Other operating income, net | (4,568) | (4,012) |
| | 245,252 | 234,977 |
| Equity in loss of New Zealand joint venture | (455) | (1,237) |
| **OPERATING INCOME BEFORE GAIN ON SALE OF A PORTION OF THE INTEREST IN THE NEW ZEALAND JOINT VENTURE** | 64,493 | 43,171 |
| Gain on sale of a portion of the interest in the New Zealand joint venture (Note 2) | 12,367 | - |
| **OPERATING INCOME** | 76,860 | 43,171 |
| Interest expense | (12,486) | (12,593) |
| Interest and miscellaneous income, net | 188 | 68 |
| **INCOME BEFORE INCOME TAXES** | 64,562 | 30,646 |
| Income tax expense | (7,609) | (4,725) |
| **NET INCOME** | 56,953 | 25,921 |
| **OTHER COMPREHENSIVE INCOME (LOSS)** | | |
| Foreign currency translation adjustments | (1,215) | (4,878) |
| Joint venture cash flow hedges | 209 | (2,350) |
| Amortization of pension and postretirement plans, net of income tax (benefit) expense of ($2,587) and $466 | 4,104 | 425 |
| **COMPREHENSIVE INCOME** | $ 60,051 | $ 19,118 |

| | | |
|---|---|---|
| **EARNINGS PER COMMON SHARE** | | |
| Basic earnings per share | $ 0.71 | $ 0.33 |
| Diluted earnings per share | $ 0.71 | $ 0.33 |

See Notes to Condensed Consolidated Financial Statements.

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**RAYONIER INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(Unaudited)**

**(Dollars in thousands)**

| | March 31, 2010 | December 31, 2009 |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | $ 152,970 | $ 74,964 |
| Accounts receivable, less allowance for doubtful accounts of $1,313 and $1,150 | 92,402 | 103,740 |
| Inventory | | |
| Finished goods | 71,485 | 70,548 |
| Work in process | 9,688 | 8,884 |
| Raw materials | 6,554 | 6,829 |
| Manufacturing and maintenance supplies | 2,227 | 2,243 |
| Total inventory | 89,954 | 88,504 |
| Income tax and alternative fuel mixture credit receivable | 191,530 | 192,579 |
| Prepaid and other current assets | 52,565 | 49,909 |
| Total Current Assets | 579,421 | 509,696 |
| **TIMBER AND TIMBERLANDS, NET OF DEPLETION AND AMORTIZATION** | 1,158,861 | 1,188,559 |
| **PROPERTY, PLANT AND EQUIPMENT** | | |
| Land | 24,812 | 24,789 |
| Buildings | 125,100 | 126,443 |
| Machinery and equipment | 1,295,702 | 1,275,955 |
| Total property, plant and equipment | 1,445,614 | 1,427,187 |
| Less - accumulated depreciation | (1,089,990) | (1,082,248) |
| | 355,624 | 344,939 |
| **INVESTMENT IN JOINT VENTURE** | 63,548 | 50,999 |
| **OTHER ASSETS** | 175,471 | 158,738 |
| **TOTAL ASSETS** | $ 2,332,925 | $ 2,252,931 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| **CURRENT LIABILITIES** | | |
| Accounts payable | $ 69,907 | $ 58,584 |
| Bank loans and current maturities | - | 4,650 |
| Accrued interest | 11,996 | 6,512 |
| Accrued customer incentives | 5,808 | 25,644 |
| Current liabilities for dispositions and discontinued operations (Note 10) | 10,910 | 10,648 |

| | | |
|---|---|---|
| Other current liabilities | 64,533 | 69,073 |
| **TOTAL CURRENT LIABILITIES** | 163,154 | 175,111 |
| **LONG-TERM DEBT** | 762,028 | 694,999 |
| **NON-CURRENT LIABILITIES FOR DISPOSITIONS AND DISCONTINUED OPERATIONS (Note 10)** | 85,683 | 87,943 |
| **PENSION AND OTHER POSTRETIREMENT BENEFITS (Note 12)** | 111,890 | 111,662 |
| **OTHER NON-CURRENT LIABILITIES** | 35,238 | 37,010 |
| **COMMITMENTS AND CONTINGENCIES (Notes 9 and 11)** | | |
| **SHAREHOLDERS EQUITY** | | |
| Common Shares, 120,000,000 shares authorized, 80,064,618 and 79,541,974 shares issued and outstanding | 570,673 | 561,962 |
| Retained earnings | 680,903 | 663,986 |
| Accumulated other comprehensive loss | (76,644) | (79,742) |
| **TOTAL SHAREHOLDERS EQUITY** | 1,174,932 | 1,146,206 |
| **TOTAL LIABILITIES AND SHAREHOLDERS EQUITY** | $ 2,332,925 | $ 2,252,931 |

See Notes to Condensed Consolidated Financial Statements.

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**RAYONIER INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

**(Dollars in thousands)**

| | Three Months Ended March 31, 2010 | 2009 |
|---|---|---|
| **OPERATING ACTIVITIES** | | |
| Net income | $ 56,953 | $ 25,921 |
| Adjustments to reconcile net income to total cash provided by operating activities: | | |
| Depreciation, depletion and amortization | 43,329 | 38,519 |
| Non-cash cost of real estate sold | 2,194 | 3,490 |
| Stock-based incentive compensation expense | 4,344 | 4,338 |
| Gain on sale of a portion of the interest in the New Zealand joint venture | (11,545) | - |
| Amortization of convertible debt discount | 2,029 | 1,442 |
| Deferred income tax expense (benefit) | 45 | (1,238) |
| Excess tax benefits on stock-based compensation | (3,153) | (68) |
| Other | 2,253 | 2,231 |
| Changes in operating assets and liabilities: | | |
| Receivables | 11,202 | (1,408) |
| Inventories | (446) | (6,470) |
| Accounts payable | 3,017 | (1,755) |
| Income tax and alternative fuel mixture credit receivable | 1,050 | 637 |
| Other current assets | (1,504) | (1,407) |
| Accrued liabilities | (15,712) | 3,516 |
| Other assets | (103) | (454) |
| Other non-current liabilities | (513) | (217) |
| Expenditures for dispositions and discontinued operations | (2,029) | (2,285) |
| CASH PROVIDED BY OPERATING ACTIVITIES | 91,411 | 64,792 |
| **INVESTING ACTIVITIES** | | |
| Capital expenditures | (36,165) | (29,828) |
| Change in restricted cash | (9,809) | (2,964) |
| Other | 8,359 | 4,118 |
| CASH USED FOR INVESTING ACTIVITIES | (37,615) | (28,674) |
| **FINANCING ACTIVITIES** | | |
| Issuance of debt | 127,000 | 20,000 |
| Repayment of debt | (66,650) | (20,000) |
| Dividends paid | (39,910) | (39,416) |
| Proceeds from the issuance of common shares | 7,211 | 218 |
| Excess tax benefits on stock-based compensation | 3,153 | 68 |
| Debt issuance costs | (397) | - |
| Repurchase of common shares | (5,997) | (1,388) |
| CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES | 24,410 | (40,518) |

| | | | | |
|---|---|---|---|---|
| **EFFECT OF EXCHANGE RATE CHANGES ON CASH** | | | (200) | 169 |
| **CASH AND CASH EQUIVALENTS** | | | | |
| Increase (decrease) in cash and cash equivalents | | | 78,006 | (4,231) |
| Balance, beginning of year | | | 74,964 | 61,685 |
| Balance, end of period | $ | | - | |
| Federal income taxes receivable | 63,842 | - | | |
| Total Current Assets | 2,921,713 | 3,295,827 | | |
| PROPERTY AND EQUIPMENT NET | 110,722 | 147,441 | | |
| OTHER ASSETS NET | 340 | 340 | | |
| DEFERRED INCOME TAX BENEFIT | 27,100 | 33,600 | | |
| | $ 3,059,875 | $ 3,477,208 | | |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | | | |
| CURRENT LIABILITIES | | | | |
| Accounts payable | $ 50,013 | $ 134,129 | | |
| Refundable deposits | - | 11,949 | | |
| Accrued wages and bonus | 3,983 | 49,252 | | |
| Accrued payroll and other taxes | 1,901 | 7,543 | | |
| Accrued vacation pay | 37,651 | 33,683 | | |
| Income tax payable | - | 12,304 | | |
| Total Current Liabilities | 93,548 | 248,860 | | |
| DEFERRED INCOME TAXES | 34,600 | 49,000 | | |
| COMMITMENTS AND CONTINGENCIES | - | - | | |
| STOCKHOLDERS EQUITY | | | | |
| Common stock - $.001 par value 50,000,000 shares authorized, 5,158,667 and 5,153,667 issued and outstanding at 2008 and 2007, respectively | 5,159 | 5,154 | | |
| Additional paid-in capital | 990,300 | 978,565 | | |
| Retained earnings | 1,936,268 | 2,195,629 | | |
| | 2,931,727 | 3,179,348 | | |
| | $ 3,059,875 | $ 3,477,208 | | |

See Notes to Financial Statements.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

**STATEMENTS OF OPERATIONS**

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| SALES NET | $ 2,108,700 | $ 3,002,521 | $ 2,617,810 |
| COST OF SALES | 951,095 | 1,155,323 | 1,018,798 |
| GROSS PROFIT | 1,157,605 | 1,847,198 | 1,599,012 |
| OPERATING EXPENSES | 1,446,312 | 1,467,051 | 1,282,761 |
| OPERATING INCOME (LOSS) | (288,707) | 380,147 | 316,251 |
| OTHER INCOME | | | |
| Interest income | 59,718 | 81,272 | 48,310 |
| Other income (expense) | 1,174 | 1,717 | (21,547) |
| | 60,892 | 82,989 | 26,763 |
| INCOME (LOSS) BEFORE INCOME TAXES | (227,815) | 463,136 | 343,014 |
| PROVISION FOR FEDERAL INCOME TAXES | (71,628) | 143,814 | 116,925 |
| NET INCOME (LOSS) | $ (156,187) | $ 319,322 | $ 226,089 |
| BASIC EARNINGS (LOSS) PER SHARE | $ (0.03) | $ 0.06 | $ 0.04 |

| | | | | | | |
|---|---|---|---|---|---|---|
| DILUTED EARNINGS (LOSS) PER SHARE | $ | (0.03) | $ | 0.06 | $ | 0.04 |

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ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

**STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

| | Common Stock | | Paid-In | Retained | Accumulated Other Comprehensive | |
|---|---|---|---|---|---|---|
| | Shares | Amount | Capital | Earnings | Loss | Total |
| BALANCE AT JANUARY 1, 2006 | 5,148,667 | $ 5,149 | $ 966,184 | $ 1,804,828 | $ (17,017) | $ 2,759,144 |
| STOCK OPTIONS EXERCISED | 5,000 | 5 | 1,995 | - | - | 2,000 |
| COMPREHENSIVE INCOME: | | | | | | |
| Net income December 31, 2006 | - | - | - | 226,089 | - | 226,089 |
| Less reclassification adjustment included in net income | - | - | - | - | 17,017 | 17,017 |
| SHARE-BASED COMPENSATION | - | - | 6,287 | - | - | 6,287 |
| CASH DIVIDEND | - | - | - | (51,537) | - | (51,537) |
| | 5,153,667 | 5,154 | 974,466 | 1,979,380 | - | 2,959,000 |
| COMPREHENSIVE INCOME: | | | | | | |
| Net income | - | - | - | 319,322 | - | 319,322 |
| | - | - | 4,099 | - | - | 4,099 |

| | | | | | | |
|---|---|---|---|---|---|---|
| SHARE-BASED COMPENSATION | | | | | | |
| CASH DIVIDEND | - | - | - | (103,073) | - | (103,073) |
| | 5,153,667 | 5,154 | 978,565 | 2,195,629 | - | 3,179,348 |
| STOCK OPTIONS EXERCISED | 5,000 | 5 | 3,895 | - | - | 3,900 |
| COMPREHENSIVE INCOME: | | | | | | |
| Net income (loss) | - | - | - | (156,187) | - | (156,187) |
| SHARE-BASED COMPENSATION | - | - | 7,840 | - | - | 7,840 |
| CASH DIVIDEND | - | - | - | (103,174) | - | (103,174) |
| BALANCE AT DECEMBER 31, 2008 | 5,158.667 | $ 5,159 | $ 990,300 | $ 1,936,268 | $ - | $ 2,931,727 |

See Notes to Financial Statements.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

**STATEMENTS OF CASH FLOWS**

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income (loss) | $ (156,187) | $ 319,322 | $ 226,089 |
| Noncash expenses included in income: | | | |
| Depreciation | 50,068 | 54,433 | 59,401 |
| Amortization | - | - | 1,433 |
| Allowance for doubtful accounts | (649) | (933) | 1,374 |
| Deferred income taxes | (7,900) | (8,900) | (14,400) |
| Loss on disposition of assets | - | - | 94 |
| Realized loss on sale of investments | - | - | 19,343 |
| Share-based compensation | 7,840 | 4,099 | 6,287 |
| Decrease (increase) in current assets: | | | |
| Accounts receivable, net | 86,284 | 120,996 | (179,519) |
| Inventory | (41,578) | (15,286) | (97,658) |
| Other current assets | (3,686) | (3,323) | 1,489 |
| Prepaid federal income taxes | (37,600) | - | - |
| Federal income taxes receivable | (63,842) | - | - |
| Increase (decrease) in current liabilities: | | | |
| Accounts payable and other current liabilities | (143,008) | 66,295 | 74,703 |
| Federal income taxes payable | (12,304) | (127,786) | 50,746 |
| Net Cash From Operating Activities | (322,562) | 408,917 | 149,382 |
| | | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Deposits and long term prepaids | - | 5,512 | 17,782 |
| Purchase of investments and certificates of deposit | (2,052,000) | (1,570,000) | (1,572,000) |
| Proceeds from sales of investments and certificates of deposit | 1,520,000 | 1,300,000 | 2,319,081 |
| Additions to property and equipment | (13,349) | (49,219) | (28,125) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net Cash From Investing Activities | | (545,349) | | (313,707) | | 736,738 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | | | | |
| Stock options exercised | | 3,900 | | - | | 2,000 |
| Cash dividend | | (103,174) | | (103,073) | | (51,537) |
| Net Cash From Financing Activities | $ | (99,274) | $ | (103,073) | | $ (49,537) |
| NET INCREASE (DECREASE) IN CASH & EQUIVALENTS | $ | (967,185) | $ | (7,863) | $ | 836,583 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | | 1,479,985 | | 1,487,848 | | 651,265 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | $ | 512,800 | $ | 1,479,985 | $ | 1,487,848 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | | | | | |
| Cash paid during the year for: | | | | | | |
| Income taxes | $ | 49,904 | $ | 280,500 | $ | 80,798 |
| Cash and cash equivalents: | | | | | | |
| Cash | $ | 53,201 | $ | 35,004 | $ | 55,665 |
| Money market | | 459,599 | | 1,444,981 | | 1,432,183 |
| | $ | 512,800 | $ | 1,479,985 | $ | 1,487,848 |

See Notes to Financial Statements.

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ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

NOTES TO FINANCIAL STATEMENTS

1.

Organization and Summary of Significant Accounting Policies

Business Organization

The Company was incorporated under the laws of the State of Washington on February 10, 1984, primarily to develop, produce, sell and distribute wireless modems that will allow communication between peripherals via radio frequency waves. On November 12, 1984, the Company sold 3,000,000 shares of its unissued common stock to the public at an offering price of $.30 per share, arbitrarily determined by the underwriter.

Effective September 13, 2007, the Company announced their establishment of a doing business as or dba structure, based on the Company s registered trade name of ESTeem (tm) Wireless Modems.

Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Estimates used in the accompanying financial statements include allowance for uncollectible accounts receivable, inventory obsolescence, useful lives of depreciable assets, and deferred income taxes. Actual results could differ from those estimates.

Concentrations of Credit Risks

Financial instruments that potentially subject the Company to credit risk consists of cash and customer receivables.

The Company places its cash with two major financial institutions. During the period, the Company had cash balances that were in excess of federally insured limits.

The Company s customers, to which trade credit terms are extended, consist of United States and local governments and foreign and domestic companies.

Revenue Recognition

The Company recognizes revenue from product sales when the goods are shipped or delivered and title and risk of loss pass to the customer. Provision for certain sales incentives and discounts to customers are accounted for as reductions in sales in the period the related sales are recorded. Products sold to foreign customers are shipped after payment is received in U.S. funds, unless an established distributor relationship exists or the customer is a foreign branch of a U.S. company.

Revenues from site support and engineering services are recognized as the Company performs the services. Amounts billed and collected before the services are performed are included in deferred revenues. Revenue is recognized based upon proportional performance when the contract contains performance milestones.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

NOTES TO FINANCIAL STATEMENTS

1.

Organization and Summary of Significant Accounting Policies - (Continued)

The Company does not generally sell its products with the right of return.  Therefore, returns are reported when they occur.

The Company warrants its products as free of manufacturing defects and provides a refund of the purchase price, repair or replacement of the product for a period of one year from the date of installation by the first user/customer.  No allowance for estimated warranty repairs or product returns has been recorded.

Financial Instruments

The Company s financial instruments are cash and cash equivalents, accounts receivable and accounts payable.  The recorded values of cash and cash equivalents, accounts receivable and accounts payable approximate their fair values based on their short-term nature.

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of cash, certificates of deposit and money market accounts purchased with original maturities of three months or less.

Allowance for Uncollectible Accounts

The Company uses the allowance method to account for uncollectible accounts receivable. Accounts receivable are presented net of an allowance for doubtful accounts of $1,477 and $2,126 as of December 31, 2008 and 2007, respectively. The Company s policy for writing off past due accounts receivable is based on the amount, time past due, and response received from the subject customer.

Accounts receivable include $690 of amounts due which are over ninety days past due at December 31, 2008.

Inventory

Inventories are stated at lower of direct cost or market. Cost is determined on an average cost basis that approximates the first-in, first-out (FIFO) method. Market is determined based on net realizable value and consideration is given to obsolescence.

Patent Costs

Expenses incurred in connection with the patent have been capitalized and have been amortized over 17 years. The patent was fully amortized at December 31, 2006.



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ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

NOTES TO FINANCIAL STATEMENTS

1.

Organization and Summary of Significant Accounting Policies - (Continued)

Property and Equipment

Property and equipment are carried at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The useful life of property and equipment for purposes of computing depreciation is three to seven years. The Company periodically reviews its long-lived assets for impairment and, upon indication that the carrying value of such assets may not be recoverable, recognizes an impairment loss by a charge against current operations. The Company normally capitalizes non-consumable assets with a cost greater than one thousand dollars.

Investments

Certificates of deposit with original maturities ranging from three months to twelve months were purchased for $1,432,000, at December 31, 2008.

Capitalized Software Costs

Capitalized software costs consist of costs to purchase and develop software. The Company capitalizes the costs of creating a software product to be sold, leased or otherwise marketed, for which technological feasibility has been established. Amortization of the software product, on a product-by-product basis, begins on the date the product is available for distribution to customers and continues over the estimated revenue-producing life, not to exceed five years. All software costs were fully amortized at December 31, 2006.

Income Taxes

The provision for income taxes is computed on the pretax income based on the current tax law. Deferred income taxes are recognized for the tax consequences in future years of differences between the tax basis of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory tax rates.

Research and Development

Research and development costs are expensed as incurred. Research and development expenditures for new product development and improvements of existing products by the Company for 2008, 2007, and 2006, were $490,239, $497,280, and $401,572, respectively.

Advertising Costs

Costs incurred for producing and communicating advertising are expensed when incurred. Advertising costs for the years ended December 31, 2008, 2007, and 2006, were $18,087, $9,040, and $17,558, respectively.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

NOTES TO FINANCIAL STATEMENTS

1.

Organization and Summary of Significant Accounting Policies - (Continued)

Reclassifications

Certain reclassifications have been made to the prior years  financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

Share-Based Compensation

Effective January 1, 2006, the Company adopted SFAS 123R, a revision of FASB Statement No. 123,  Accounting for Stock-Based Compensation . SFAS 123R requires all share-based payments to employees, including grants of employee stock options, be measured at fair value and expensed in the statement of operations over the service period. See Note 8 for additional information. In addition to the recognition of expense in the financial statements, under SFAS 123R, any excess tax benefits received upon exercise of options will be presented as a financing activity inflow rather than an adjustment of operating activity as presented in prior years.

2.

Inventories

Inventories consist of the following:

| | 2008 | 2007 |
|---|---|---|
| Parts | $ 312,540 | $ 250,701 |
| Work in progress | 4 | 108,101 |
| Finished goods | 327,235 | 239,399 |
| | $ 639,779 | $ 598,201 |

3.

Property and Equipment

Property and equipment consist of the following:

| | 2008 | 2007 |
|---|---|---|
| Laboratory equipment | $ 565,053 | $ 551,704 |
| Furniture and fixtures | 16,398 | 16,398 |
| Dies and molds | 105,353 | 105,353 |
| | 686,804 | 673,455 |
| Accumulated depreciation | (576,082) | (526,014) |
| | $ 110,722 | $ 147,441 |

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

NOTES TO FINANCIAL STATEMENTS

4.

Other Assets

Other assets consist of the following:

| | 2008 | 2007 |
|---|---|---|
| Patent costs | $ 1,850 | $ 1,850 |
| Software costs | 86,330 | 86,330 |
| | 88,180 | 88,180 |
| Accumulated amortization | (88,180) | (88,180) |
| | - | - |
| Deposits | 340 | 340 |
| | $ 340 | $ 340 |

5.

Provision for Income Taxes

The Company uses the asset and liability approach in accounting for income taxes.

The provision for federal income taxes consisted of:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Current | $ (63,728) | $ 152,714 | $ 140,090 |

| | | | |
|---|---|---|---|
| Deferred | (7,900) | (8,900) | (23,165) |
| Provision for federal income taxes | $ (71,628) | $ 143,814 | $ 116,925 |

The components of deferred tax assets and liabilities at December 31, were as follows:

| | 2008 | 2007 |
|---|---|---|
| Deferred tax assets: | | |
| Accrued liabilities | $ 12,800 | $ 11,400 |
| Inventory adjustment | 4,800 | 8,100 |
| Capital loss carryforward | 9,000 | 9,800 |
| Other | 500 | 4,300 |
| Total | $ 27,100 | $ 33,600 |
| Deferred tax liabilities: | | |
| Depreciable property | $ 34,600 | $ 49,000 |
| Total | $ 34,600 | $ 49,000 |

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

NOTES TO FINANCIAL STATEMENTS

5.

Provision for Income Taxes (Continued)

The differences between the provision for income taxes and income taxes computed using the U.S. federal income tax rate were as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Amount computed using the statutory rate | $ (63,728) | $ 152,714 | $ 140,090 |
| Increase (decrease) in deferred tax (assets) liabilities | (7,900) | (8,900) | (14,400) |
| Decrease in deferred tax asset reclassification adjustment accumulated other comprehensive loss | - | - | (8,765) |
| Provision for federal income taxes | $ (71,628) | $ 143,814 | $ 116,925 |

The Company files federal income tax returns in the United States only. The Company is no longer subject to federal income tax examination by tax authorities for years before 2004. Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN48). FIN48 prescribes a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The Company has evaluated all tax positions for open years and has concluded that they have no material unrecognized tax benefits.

For the years ended December 31, 2008, 2007, and 2006, the provision for federal income taxes included penalties of $114, $2,314, and $2,805, respectively.

6.

Profit Sharing Salary Deferral 401-K Plan

The Company sponsors a Profit Sharing Plan and Salary Deferral 401-K plan and trust. All employees over the age of twenty-one are eligible. On January 1, 2006, the Company adopted a four percent salary matching provision. The Company contributed $-0-, $34,147 and $23,758 to the plan at December 31, 2008, 2007, and 2006, respectively.

7.

Employee Profit Sharing Bonus Program

The Company makes contributions to the Employees Profit Sharing Bonus Program (a non-qualified plan) based upon ten percent of the first $100,000 of pre-tax net income plus eight percent on pre-tax net income in excess of $100,000. The Company has accrued contributions for the years 2008, 2007, and 2006, of $-0-, $42,447, and $31,998, respectively.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

NOTES TO FINANCIAL STATEMENTS

8.

Share-Based Compensation

Effective January 1, 2006, the Company adopted SFAS 123R using the modified prospective transition method. The Company previously accounted for these plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB25), and related interpretations and disclosure requirements established by SFAS 123, Accounting for Stock-Based Compensation .

The Company grants stock options to individual employees and directors with three years continuous tenure. After termination of employment, stock options may be exercised within ninety days.

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:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Dividend yield | 2.35% | 1.43% | 1.43% |
| Expected volatility | 75% | 39% | 49% |
| Risk-free interest rate | 2.24% | 4.40% | 4.67% |
| Expected term (in years) | 3 | 3 | 3 |
| Estimated fair value per option granted | $ 0.39 | $ 0.21 | $ 0.25 |

The average risk-free interest rate is based on the three-year U.S. Treasury Bond rate in effect as of the grant date. The expected volatility is determined using a weighted average of weekly historical volatility of the stock price over a period of one year prior to the grant dates. The Company uses historical data to estimate option exercise rates. The option exercise rate for option grants in 2008 was ten percent.

In the years ended December 31, 2008, 2007, and 2006, the Company recognized $7,840, $4,099, and $6,287, respectively, in share-based compensation expense. No non-vested share-based compensation arrangements existed as of December 31, 2008.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

NOTES TO FINANCIAL STATEMENTS

8.

Share-Based Compensation (Continued)

A summary of option activity follows:

| | Number Outstanding | Weighted -Average Exercise Price Per Share | Weighted -Average Remaining Contractual Term (Years) |
|---|---|---|---|
| Balance at 12/31/05 | 545,000 | $ 0.68 | 1.1 |
| Granted | 215,000 | 0.68 | |
| Exercised | (5,000) | 0.40 | |
| Canceled | (195,000) | 0.48 | |
| Balance at 12/31/06 | 560,000 | 0.72 | 1.1 |
| Granted | 180,000 | 0.68 | |
| Exercised | - | - | |
| Canceled | (185,000) | 0.80 | |
| Balance at 12/31/07 | 555,000 | 0.71 | 1.1 |
| Granted | 200,000 | 0.81 | |
| Exercised | (5,000) | 0.78 | |
| Canceled | (180,000) | 0.78 | |
| Balance at 12/31/08 | 570,000 | 0.73 | 1.1 |
| Exercisable at 12/31/08 | 570,000 | 0.73 | 1.1 |

9.

Earnings Per Share

The following table represents the calculation of net earnings per common share basic and diluted:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Net income (loss) | $ (156,187) | $ 319,322 | $ 226,089 |
| Basic earnings per share: | | | |
| Weighted average shares outstanding | 5,157,916 | 5,153,667 | 5,152.968 |
| Diluted earnings per share: | | | |
| Weighted average shares outstanding | 5,157,916 | 5,153,667 | 5,152,968 |
| Incremental shares from assumed conversion of stock options | - | 88,722 | 12,378 |
| Weighted average shares outstanding | 5,157,916 | 5,242,389 | 5,165,346 |
| Net earnings (loss) per common share-basic | $ (0.03) | $ 0.06 | $ 0.04 |
| Net earnings (loss) per common share-diluted | $ (0.03) | $ 0.06 | $ 0.04 |

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

NOTES TO FINANCIAL STATEMENTS

10.

Leases

The Company leases its facilities from a port authority, under beneficial terms for $3,692 monthly for three years, expiring in September 2011, with annual increases based upon the Consumer Price Index. The lease expense for the years ended December 31, 2008, 2007, and 2006 was $43,536, $41,733 and $39,672, respectively.

Future minimum lease payments required under the above operating lease for the years ending December 31, follows:

| | |
|---|---|
| 2009 | $ 44,824 |
| 2010 | 46,885 |
| 2011 | 36,323 |
| | $ 128,032 |

11.

Related Party Transactions

For the years ended December 31, 2008, 2007, and 2006, services in the amount of $114,403, $126,326, and $152,520, respectively, were contracted with a manufacturing process company, Manufacturing Services, Inc. The president and past president of Manufacturing Services, Inc., are members of the Board of Directors of Electronic Systems Technology, Inc. Accounts payable include $527 of payables to Manufacturing Services, Inc., at December 31, 2008.

12.

Commitments and Contingencies

The Company purchases certain key components necessary for the production of its products from a limited number of suppliers.  The components provided by the suppliers could be replaced or substituted by other products.  It is possible that if this action became necessary, an interruption of production and/or material cost expenditures could take place.

13.

Segment Reporting

Segment information is prepared on the same basis that the Company s management reviews financial information for operational decision making purposes.  Electronic Systems Technology, Inc., 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.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

NOTES TO FINANCIAL STATEMENTS

13.

Segment Reporting (Continued)

Domestic customers represent approximately seventy-two percent of total net revenues. Foreign customers represent approximately twenty-eight percent of total net revenues. No individual customer comprised more than ten percent of sales revenue. Revenues from foreign countries consist primarily of revenues from Canada, Mexico, and South American countries.

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.

Summary financial information for the two reportable segments is as follows:

| | | | Unallocated | |
|---|---|---|---|---|
| 2008 | Domestic | Foreign | Corporate | Total |
| Total sales | $ 1,515,876 | $ 592,824 | $ - | $ 2,108,700 |
| Total other income | 60,892 | - | - | 60,892 |
| Depreciation | 47,348 | - | 2,720 | 50,068 |
| Earnings (loss) before tax | (129,161) | 187,866 | (286,520) | (227,815) |
| Identifiable assets | 231,963 | 65,809 | 2,762,103 | 3,059,875 |
| Net capital expenditures | 9,851 | - | 3,498 | 13,349 |
| 2007 | | | | |
| Total sales | $ 2,061,658 | $ 940,863 | $ - | $ 3,002,521 |

| | | | | |
|---|---|---|---|---|
| Total other income | 82,989 | - | - | 82,989 |
| Depreciation | 51,917 | - | 2,516 | 54,433 |
| Earnings (loss) before tax | 311,594 | 481,822 | (330,280) | 463,136 |
| Identifiable assets | 359,028 | 61,870 | 3,056,310 | 3,477,208 |
| Net capital expenditures | 46,361 | - | 2,858 | 49,219 |
| 2006 | | | | |
| Total sales | $ 2,100,711 | $ 517,099 | $ - | $ 2,617,810 |
| Total other income | 26,763 | - | - | 26,763 |
| Depreciation | 57,157 | - | 2,244 | 59,401 |
| Earnings (loss) before tax | 427,513 | 189,327 | (273,826) | 343,014 |
| Identifiable assets | 498,439 | 48,055 | 2,773,357 | 3,319,851 |
| Net capital expenditures | 27,525 | - | 600 | 28,125 |

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

SUPPLEMENTAL SCHEDULES

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

**SUPPLEMENTAL SCHEDULES OF OPERATING EXPENSES**

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, AND 2006

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Advertising | $ 18,087 | $ 9,040 | $ 17,558 |
| Amortization | - | - | 1,433 |
| Bad debt | - | - | 5,059 |
| Commissions sales | 6,680 | 4,230 | 4,144 |
| Dues and subscriptions | 2,347 | 2,145 | 1,740 |
| Depreciation | 50,068 | 54,433 | 59,401 |
| Insurance | 13,144 | 13,527 | 13,618 |
| Materials and supplies | 37,328 | 44,740 | 49,850 |
| Office and administration | 12,438 | 14,204 | 13,253 |
| Printing | 6,630 | 9,294 | 8,543 |
| Professional services | 302,231 | 333,603 | 191,817 |
| Rent and utilities | 57,140 | 56,295 | 53,751 |
| Repair and maintenance | 5,016 | 13,820 | 17,533 |
| Salaries | 987,551 | 988,322 | 822,995 |
| Taxes | 231,104 | 198,128 | 189,204 |
| Telephone | 10,681 | 11,918 | 12,935 |
| Trade shows | 37,737 | 40,112 | 46,527 |
| Travel expenses | 98,659 | 100,553 | 85,145 |
| | 1,876,841 | 1,894,364 | 1,594,506 |
| Expenses allocated to cost of sales | (430,529) | (427,313) | (311,745) |
| | $ 1,446,312 | $ 1,467,051 | $ 1,282,761 |

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

**SUPPLEMENTAL SCHEDULES OF SELECTED FINANCIAL DATA**

FOR THE YEARS ENDED DECEMBER 31, 2008, 2007, 2006, 2005 AND 2004

| | 2008 | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|---|
| Sales net | $ 2,108,700 | $ 3,002,521 | $2,617,810 | $ 2,417,700 | $ 2,416,625 |
| Gross profit | 1,157,605 | 1,847,198 | 1,599,012 | 1,305,017 | 1,332,777 |
| Income (loss) before provision for income taxes | (227,815) | 463,136 | 343,014 | 174,757 | 260,126 |
| Provision for income taxes | (71,628) | 143,814 | 116,925 | 61,694 | 85,306 |
| Net income (loss) | (156,187) | 319,322 | 226,089 | 113,063 | 174,820 |
| Other comprehensive loss, net of tax | - | - | - | (5,905) | (6,350) |
| Comprehensive income (loss) | (156,187) | 319,322 | 226,089 | 107,158 | 168,470 |
| Net income (loss) per share basic | (0.03) | 0.06 | 0.04 | 0.02 | 0.03 |
| Weighted average number of shares outstanding | 5,157,916 | 5,153,667 | 5,152,968 | 5,148,667 | 5,104,678 |
| Total assets | 3,059,875 | 3,477,208 | 3,319,851 | 2,994,581 | 2,983,296 |
| Stockholders equity | 2,931,727 | 3,179,348 | 2,959,000 | 2,759,144 | 2,698,761 |
| Stockholders equity per share | 0.57 | 0.62 | 0.57 | 0.54 | 0.53 |
| Working capital | 2,828,165 | 3,046,967 | 2,824,793 | 2,588,752 | 2,498,881 |
| Current ratio | 31.2:1 | 13.2:1 | 10.1:1 | 15.7:1 | 13.0:1 |
| Equity to total assets | 96% | 91% | 89% | 92% | 90% |

**Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure.**

None

**Item 9A. Controls and Procedures.**

***Conclusions of Management Regarding Effectiveness of Disclosure Controls and Procedures.***

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures pursuant to Exchange Act Rule 15d-15(e) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that there was a material weakness affecting our internal control over financial reporting and, as a result of this weakness, our disclosure controls and procedures were not effective as of December 31, 2008.

***Management s Report on Internal Control over Financial Reporting.***

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.

As of December 31, 2008 management conducted an assessment of the effectiveness of EST s internal control over financial reporting based on the criteria for effective internal control over financial reporting established in Internal Control Integrated Framework, issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based upon this assessment, we 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 December 31, 2008. The material weakness is as follows:

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

*Management s Remediation Initiatives*

Management has evaluated and continues to evaluate, avenues for mitigating our internal controls weaknesses, but mitigating controls that are practical and cost effective have not be found based on the size and structure of our organization. Taking into account our net loss for 2008, and the uncertainty posed by the current United States and world wide economic downturn, Management does not foresee implementing a cost effective method of mitigating our internal controls weaknesses in the near term. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks.

*Changes in internal control over financial reporting*.

Except as noted above, there have been no changes during the quarter ended December 31, 2008 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.



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**Item 9B. Other Information.**

On February 19, 2009 stock options to purchase shares of the Company's common stock were granted to individual employees and directors with no less than three years continuous tenure. The options granted on February 19, 2009 totaled 195,000 shares under option and have an exercise price of $0.31 per share. The options granted on February 19, 2009 may be exercised any time during the period from February 19, 2009 through February 19, 2012. The Company's Form 8-K filed February 20, 2009 is included herein by reference.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance.**

IDENTIFICATION OF DIRECTORS:

The following table sets forth the names and ages of all directors of the Company as of December 31, 2008; as well as term in office and principal occupation of each director.

| **Name of Director** | **Term in Office** | | **Age** | **Principal Occupation** |
|---|---|---|---|---|
| T.L. Kirchner | 06/06/08 | 06/06/11 | 60 | President of the Company |
| Melvin H. Brown | 06/02/06 | 06/02/09 | 78 | Former President of Manufacturing Services, Inc. |
| Michael S. Brown | 06/06/08 | 06/06/11 | 56 | President of Manufacturing Services, Inc. |
| Robert Southworth | 06/02/06 | 06/02/09 | 65 | Patent Attorney, U.S. Dept. of Energy (retired) |
| Jon Correio | 06/02/06 | 06/02/09 | 41 | Vice President of Finance of the Company |
| John L. Schooley | 06/04/07 | 06/04/10 | 69 | Former President of Remtron, Inc. |

Management believes that there are no agreements or understanding between the directors and suppliers or contractors of the Company, except the agreement with Manufacturing Services, Inc. as described elsewhere in this report.

Audit Committee

The Audit Committee of the Board of Directors as of December 31, 2008 is comprised of Michael Brown (Chairman), Melvin Brown, Robert Southworth and John Schooley. Michael Brown and Melvin Brown are considered to be non-independent members of the Audit Committee, however their serving on the Audit Committee was deemed by the Board to be in the best interest of the Corporation due to Michael Brown and Melvin Brown s experience and familiarity with the Corporation. The Board of Directors has determined that none of the audit committee members can be classified as an audit committee financial expert as defined in Item 407(d)(5)(ii) of Regulation S-K. The Board of Directors does not contain a member that can be classified as an audit committee financial expert under the referenced definition. The Board of Directors believes that attracting and retaining board members that could be classified as an audit committee financial expert is unlikely due to the high cost of such Director candidates.

The Board of Directors had an Employee/Director Stock Option Committee consisting of Tom Kirchner and Jon Correio. The committee existed for the sole purpose of recommending the recipients and amounts of the Company awarded stock options during 2008.

Compensation Committee

There is no Compensation Committee of the Board of Directors.

Code of Ethics

On June 2, 2005, the Company's Board of Directors adopted a Code of Ethics for the Company. This Code of Ethics is filed herewith as an exhibit.

IDENTIFICATION OF EXECUTIVE OFFICERS

The following table sets forth the names and ages of all executive officers of the Company as of December 31, 2008; all positions by such persons; term of office and the period during which he has served as such; and any arrangement or understanding between him and any other person(s) pursuant to which he was elected as an officer:

| Name of Officer | Age | Position | Term of Office | Period of Service |
|---|---|---|---|---|
| T. L. Kirchner | 60 | President/CEO | 3 Years | 02/10/84- Present |
| Jon Correio | 41 | Vice President, Finance & Administration/ Sec/Treas | 3 Years | 02/9/01- Present |

The following is a brief description of the business experience during the last five years of each director and/or executive officer of the Company.

T.L. KIRCHNER. Mr. Kirchner is founder, President and a Director of the Company. During the last five years Mr. Kirchner devoted 100% of his time to the management of the Company. His primary duties are to oversee the management and marketing functions of the Company. Mr. Kirchner does not serve as a director for any other company registered under the Securities Exchange Act.

MELVIN H. BROWN. Mr. Brown is a Director of the Company. During the last five years Mr. Brown has been the owner and President of Manufacturing Services, Inc until his retirement in 2006. Manufacturing Services provides electronic design and manufacturing solutions. Manufacturing Services provides electronic manufacturing and quality control testing services for Electronic Systems Technology. Mr. Brown does not serve as a director for any other company registered under the Securities Exchange Act.

MICHAEL S. BROWN. Mr. Brown is a Director of the Company. He has been with Manufacturing Services, Inc. since 1998 and became President in April 2006. Previously Mr. Brown held management positions with Cadence Design Systems and Wyse Technology. Manufacturing Services provides electronic design and manufacturing solutions. Manufacturing Services provides electronic manufacturing and quality control testing services for Electronic Systems Technology. Mr. Brown does not serve as a director for any other company registered under the Securities Exchange Act.

ROBERT SOUTHWORTH. Mr. Southworth is a Director of the Company. Mr. Southworth is a retired Senior Patent Attorney with the U. S. Department of Energy in Richland, Washington. His primary duties with the Department of Energy were the preparation and prosecution of domestic and foreign patent applications in such fields as nuclear reactors, fuel reprocessing, waste management and energy related fields of solar, wind, and fossil fuels. Mr. Southworth does not serve as a director of any other company that is registered under the Securities Exchange Act

JON CORREIO. Mr. Correio is the Vice President of finance and administration, Secretary/Treasurer and a Director of the Company. During the last five years Mr. Correio has been a full time employee of the Company, whose primary duties are to oversee the finance and administration functions of the Company. Mr. Correio does not serve as a director for any other company registered under the Securities Exchange Act.

JOHN L. SCHOOLEY. Mr. Schooley is a Director of the Company. During the past five years, Mr. Schooley was the former owner and President of Remtron, Inc. in San Diego, California. Remtron, Inc. manufactures advanced radio control and telemetry systems for the industrial marketplace. Mr. Schooley does not serve as director of any other company that is registered under the Securities Exchange Act.

FAMILIAL RELATIONSHIPS

Melvin H. Brown is the father of Michael S. Brown, both of whom are Directors of the Company. Outside of this family relationship, there are no family relationships, whether by blood, marriage, or adoption, between any of the Directors or Executive Officers of the Company.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

During the year ended December 31, 2008, to the knowledge of Management, there was no director, officer, or beneficial owner of more than 10% any class of equity securities of the registrant who failed to file on a timely basis the required disclosure form as required by Section 16(a) of the Securities and Exchange Act of 1934.

**Item 11. Executive Compensation.**

The Company s principal executive officer is T.L. Kirchner, President and CEO. The Company s principal financial officer is Jon Correio, Vice President, Finance and Administration.

Information concerning the compensation of the Company s principal executive officer and principal financial officer, as well as any other compensated employees of the Registrant's whose total compensation exceeded $100,000 during 2008 and 2007 is provided in the following Summary Compensation Table:

SUMMARY COMPENSATION TABLE

| **Name and Principal Position** | **Year** | **Salary ($)** | **Bonus ($)(1)** | **Stock Awards ($)** | **Option Awards ($)(2)** | **Non-Equity Incentive Plan Compensation ($)** | **Non-qualified Deferred Compensation Earnings ($)** | **All Other Compen-sation ($)(3)(4)** | **Total ($)** |
|---|---|---|---|---|---|---|---|---|---|
| **(a)** | **(b)** | **(c)** | **(d)** | **(e)** | **(f)** | **(g)** | **(h)** | **(i)** | **(j)** |
| T.L. Kirchner, President/ CEO | 2008 | $159,166 | $11,770 | - | $975 | - | - | $22,423 | $194,334 |
| | 2007 | $147,917 | $7,141 | - | $578 | - | - | $17,114 | $172,750 |
| D. Brent Strecker, Vice President, Engineering | 2008 | $75,000 | $5,968 | - | $585 | - | - | $19,885 | $101,438 |
| Jon Correio, Vice President, Finance | 2008 | $75,000 | $5,968 | - | $975 | - | - | $18,797 | $100,740 |
| | 2007 | $75,000 | $3,542 | - | $578 | - | - | $18,464 | $97,584 |

(1)

Includes amounts paid under the Non-qualified Employee Profit Sharing Bonus

(2)

Amount represents the dollar amount recognized for financial statement reporting purposes in accordance with SFAS 123R. Assumptions made in the valuation of stock option awards are disclosed in Note 8 of the Notes to the Consolidated Financial Statements in this Form 10-K.

(3)

All Other Compensation consists of premiums paid for Group Health Insurance, Key Man Insurance, Accrued Vacation Pay and Company paid 401(k) matching amounts.

(4)

Amounts do not reflect proceeds of $0.02 per share cash distribution received by T.L. Kirchner during 2008 totaling $8,070. Receipt of cash distribution was based solely on capacity as a shareholder.

The information specified concerning the stock options of the named executive officers during the fiscal year ended December 31, 2008 is provided in the following Option/SAR Grants in the Last Fiscal Year Table:

OPTION/SAR GRANTS IN LAST FISCAL YEAR

**Individual Grants (5)**

| **(a)** | **(b)** | **(c)** | **(d)** | **(e)** |
|---|---|---|---|---|
| | **Number of Securities Underlying Options/SARs Granted # (5)** | **% of Total Options/SARs Granted to Employees in Fiscal Year** | **Exercise or base price ($/Share)** | |
| **Name** | | | | **Expiration Date** |
| T.L. Kirchner | 25,000 | 12.5% | 0.81 | 2/21/2011 |
| Jon Correio | 25,000 | 12.5% | 0.81 | 2/21/2011 |

(5)

This table does not include Stock Options granted previously. Forms 8-K dated 2/10/06 and 02/16/07 respectively, are incorporated herein by reference.

The information specified concerning the stock options of the named executive officers during the fiscal year ended December 31, 2008 is provided in the following Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year-End Options/SAR Values Table:

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

| | **Option Awards** | | | | | **Stock Awards** | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Name** | **Number of Securities Underlying Unexercised Options (#) Exercisable** | **Number of Securities Underlying Unexercised Options (#) Unexercisable** | **Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#)** | **Option Exercised Price ($)** | **Option Expiration Date** | **Number of Shares or Units of Stock That Have Not Vested (#)** | **Market Value of Shares or Units of Stock That Have Not Vested ($)** | **Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)** | **Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)** |
| **(a)** | **(b)** | **(c)** | **(d)** | **(e)** | **(f)** | **(g)** | **(h)** | **(i)** | **(j)** |
| T.L. Kirchner, | 25,000 | 0 | 0 | $0.81 | 2/21/11 | 0 | 0 | 0 | 0 |
| | 25,000 | 0 | 0 | $0.68 | 2/15/10 | 0 | 0 | 0 | 0 |
| President/ CEO | 25,000 | 0 | 0 | $0.68 | 2/09/09 | 0 | 0 | 0 | 0 |
| Jon Correio, | 25,000 | 0 | 0 | $0.81 | 2/21/11 | 0 | 0 | 0 | 0 |
| | 25,000 | 0 | 0 | $0.68 | 2/15/10 | 0 | 0 | 0 | 0 |
| Vice President, | 25,000 | 0 | 0 | $0.68 | 2/09/09 | 0 | 0 | 0 | 0 |

Finance

The Company does not currently have a Long-Term Incentive Plan ( LTIP ).

Compensation to outside directors is limited to reimbursement of out-of-pocket expenses that are incurred in connection with the directors duties associated with the Company's business. Directors with no less than three years continuous tenure are eligible for stock option awards, as governed by the Company stock option plan. There is currently no other compensation arrangements for the Company s directors. (See Security Ownership of Certain Beneficial Owners and Management for Stock Options granted in previous years.) The information specified concerning items of Director Compensation for the fiscal year ended December 31, 2008 is provided in the following Director Compensation Table:

DIRECTOR COMPENSATION

| **Name (1)** | **Fees Earned or Paid in Cash ($)** | **Stock Awards ($)** | **Option Awards ($)(2)** | **Non-Equity Incentive Plan Compensation ($)** | **Nonqualified Deferred Compensation Earnings ($)** | **All Other Compensation ($)(3)** | **Total ($)** |
|---|---|---|---|---|---|---|---|
| **(a)** | **(b)** | **(c)** | **(d)** | **(e)** | **(f)** | **(g)** | **(h)** |
| Melvin Brown | $0 | $0 | $975 | $0 | $0 | $0 | $975 |
| Michael Brown | $0 | $0 | $0 | $0 | $0 | $0 | $0 |
| John Schooley | $0 | $0 | $975 | $0 | $0 | $1,143 | $2,118 |
| Robert Southworth | $0 | $0 | $975 | $0 | $0 | $545 | $1,520 |

(1) Compensation information for Tom Kirchner, President and CEO, and Jon Correio, Vice President, Finance & Administration is contained in the Executive Compensation Summary Compensation Table.

(2) Amount represents the dollar amount recognized for financial statement reporting purposes in accordance with SFAS 123R. Assumptions made in the valuation of stock option awards are disclosed in Note 8 of the Notes to the Consolidated Financial Statements in this Form 10-K.

(3) Amounts represent reimbursement of out-of-pocket expenses related to directors duties associated with the Company's business (ie. travel expenses for attending Company Director s Meetings).

The Company currently does not hold any Employment Contracts or Change of Control Arrangements with any parties.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

The following table sets forth, as of December 31, 2008, the amount and percentage of the Common Stock of the Company, which according to information supplied by the Company, is beneficially owned by each person who, to the best knowledge of the Company, is the beneficial owner (as defined below) of more than five (5%) of the outstanding common stock.

| Title of Class | Name & Address Of Beneficial Owner (1) | Amount & Nature of Beneficial Ownership | Percent of Class |
|---|---|---|---|
| Common | Paul D. Sonkin<br>460 Park Avenue, 12th Floor<br>New York NY 10022 | 831,252 | 16% |
| Common | EDCO Partners LLP<br>4605 Denice Drive<br>Englewood CO 80111 | 489,180 | 9.5% |
| Common | T.L. Kirchner<br>415 N. Quay St.<br>Kennewick WA 99336 | 403,488 (2)(3) | 7.8% |

(1)

Under Rule 13d-3, issued by the Securities and Exchange Commission, a person is, in general, deemed to "Beneficially own" any shares if such person directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares (a) voting power, which includes the power to vote or to direct the voting of those shares and/or (b) investment power, which included the power to dispose, or to direct the disposition of those securities. The foregoing table gives effect to shares deemed beneficially owned under Rule 13d-3 based on the information supplied to the Company. To the knowledge of the Company, the persons named in the table have sole voting power and investment power with respect to all shares of Common Stock beneficially owned by them.

(2)

The beneficial owner listed above has stock options giving the right to acquire 75,000 shares of Electronic Systems Technology, Inc. Common Stock: Options for 25,000 shares granted February 10, 2006, Options for 25,000 shares granted February 16, 2007 and Options for 25,000 shares granted February 21, 2008. Forms 8-K, dated February 10, 2006, February 16, 2007 and February 21, 2008, respectively, are incorporated herein by reference.

(3)

Does not include options granted. See footnote (1) above.

SECURITY OWNERSHIP OF MANAGEMENT

The following table sets forth, as of February 29, 2008, amount and percentage of the Common Stock of the Company, which according to information supplied by the Company, is beneficially owned by Management, including officers and directors of the Company.

| **Title of Class** | **Name of Beneficial Owner** | **Amount & Nature of Beneficial Ownership** | **Percent of Class** |
|---|---|---|---|
| Common | T.L. Kirchner (Officer & Director) | 403,488 (1) | 7.8% |
| Common | Robert Southworth (Director) | 0 (1) | 0.0% |
| Common | Melvin H. Brown (Director) | 76,500 (1) | 1.5% |
| Common | Michael S. Brown (Director) | 0 | 0.0% |
| Common | Jon Correio (Officer &Director) | 0 (1) | 0.0% |
| Common | John Schooley (Director) | 135,000 (1) | 2.6% |
| Common | D.B. Strecker (VP of Engineering) | 24,719 (1) | 0.5% |

(1) Does not include stock options. See below.

On various dates, the Company's Board of Directors has approved Stock Option Bonuses for Directors and Employees. The following is a summary of the Stock Option bonuses currently outstanding: Options are exercisable at fixed prices. Options may not be exercised in blocks of less than 5,000 shares. Options not exercised expire three years after approval date or 90 days following termination of employment/board membership, whichever occurs first. In the event of acquisition, merger, recapitalization or similar

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events of the Company, the optionee will receive equivalent shares or will have a 10-day window in which to exercise the options. Option grants are not transferable or assignable except to the optionee's estate in the event of the optionee's death.

The information below does not include stock options granted in February 2009.

Recipients of Stock Options currently unexpired as of December 31, 2008 were as follows:

| Name | Option Shares | Exercise Price Per Share ($) |
|---|---|---|
| **APPROVAL DATE: 2-22-2008** | | |
| Sam Amaral | 5,000 | 0.81 |
| Melvin Brown | 25,000 | 0.81 |
| Thomas Brown | 5,000 | 0.81 |
| Alan B. Cook | 5,000 | 0.81 |
| Jon Correio | 25,000 | 0.81 |
| Robert Croft | 5,000 | 0.81 |
| Tom Kirchner | 25,000 | 0.81 |
| Eric P. Marske | 15,000 | 0.81 |
| Anthony C. Pfau | 5,000 | 0.81 |
| Gary L. Schmitz | 5,000 | 0.81 |
| John L. Schooley | 25,000 | 0.81 |
| Robert Southworth | 25,000 | 0.81 |
| George Stoltz | 5,000 | 0.81 |
| David B. Strecker | 15,000 | 0.81 |
| Dan Tolley | 5,000 | 0.81 |

| Name | Option Shares | Exercise Price Per Share ($) |
|---|---|---|
| **APPROVAL DATE: 2-16-2007** | | |

| | | |
|---|---|---|
| Sam Amaral | 5,000 | 0.68 |
| Melvin Brown | 25,000 | 0.68 |
| Thomas Brown | 5,000 | 0.68 |
| Alan B. Cook | 5,000 | 0.68 |
| Jon Correio | 25,000 | 0.68 |
| Tom Kirchner | 25,000 | 0.68 |
| Eric P. Marske | 15,000 | 0.68 |
| Anthony C. Pfau | 5,000 | 0.68 |
| Gary L. Schmitz | 5,000 | 0.68 |
| John L. Schooley | 25,000 | 0.68 |
| Robert Southworth | 25,000 | 0.68 |
| George Stoltz | 5,000 | 0.68 |
| Dan Tolley | 5,000 | 0.68 |

| Name | Option Shares | Exercise Price Per Share ($) |
|---|---|---|
| **APPROVAL DATE: 2-10-2006** | | |
| Sam Amaral | 15,000 | 0.68 |
| Melvin Brown | 25,000 | 0.68 |
| Thomas Brown | 5,000 | 0.68 |
| Alan B. Cook | 15,000 | 0.68 |
| Jon Correio | 25,000 | 0.68 |
| Tom Kirchner | 25,000 | 0.68 |
| Eric P. Marske | 15,000 | 0.68 |
| Gary L. Schmitz | 5,000 | 0.68 |
| John L. Schooley | 25,000 | 0.68 |
| Robert Southworth | 25,000 | 0.68 |
| George Stoltz | 5,000 | 0.68 |
| David B. Strecker | 15,000 | 0.68 |

Stock options must be exercised within 90 days after termination of employment/board membership. During 2008, 180,000 options expired, 200,000 shares were granted and 5,000 shares under option were exercised. At December 31, 2008 there were 570,000 shares reserved for future exercise.

**Item 13. Certain Relationships and Related Transactions, and Director Independence.**

TRANSACTIONS WITH MANAGEMENT AND OTHERS

During 2008, the Company contracted for services from Manufacturing Services, Inc. in the amount of $114,403. Manufacturing Services, Inc. is owned and operated by Michael S. Brown. Mr. Brown, and the former owner of Manufacturing Services, Inc, Melvin H. Brown, are currently Directors of Electronic Systems Technology, Inc. Management believes all prices for services, provided by Manufacturing Services, Inc., were as favorable as could be obtained from comparable manufacturing services companies.

**Item 14. Principal Accountant Fees and Services.**

Audit and Non-Audit Fees

The following table presents fees billed to us during December 31, 2008 and 2007, for professional services provided by Moe O'Shaughnessy & Associates P.S.

| Year Ended | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Audit fees (1) | $45,890 | $42,864 |
| Audit-related fees (2) | - | - |
| Tax fees (3) | 1,700 | 1,550 |
| All other fees (4) | - | - |
| Total Fees | $47,590 | $44,414 |

(1) Audit fees consist of fees billed for professional services normally provided in connection with the audit of the Company s financial statements and reviews of our quarterly financial statements.

(2) Audit-related fees consist of assurance and reasonably related services that include, but are not limited to, internal control reviews, attest services not required by statute or regulation and consultation concerning financial accounting and reporting standards.

(3) Tax fees consist of the aggregate fees billed for professional services for tax compliance, tax advice, and tax planning. These services include preparation of federal income tax returns.

(4) All other fees consist of fees billed for products and services other than the services reported above.

Our Audit Committee reviewed the audit and tax services rendered by Moe O'Shaughnessy & Associates P.S. and concluded that such services were compatible with maintaining the auditors independence. All audit, non-audit, tax services, and other services performed by our independent accountants are pre-approved by our Audit Committee to assure that such services do not impair the auditors independence from us. We do not use Moe O Shaughnessy & Associates P.S. for financial information system design and implementation. These services, which include designing or implementing a system that aggregates source data underlying the financial statements or generates information that is significant to our financial statements, are provided internally. We do not engage Moe O Shaughnessy & Associates P.S. to provide compliance outsourcing services.

**PART III**

**Item 15. Exhibits and Financial Statement Schedules.**

Exhibits filed as part of the Company s 10K report for 2008 are listed below. Certain exhibits have been previously filed with the Securities and Exchange Commission and are incorporated by reference.

| EXHIBIT NUMBER | DESCRIPTION |
|---|---|
| 3 | Articles of Incorporation and By-Laws filed as Exhibit 2.1 to Form S-18,<br><br>Registration Statement No. 2-92949-S, Exhibit (c) to Form 8-K, filed March 15, 1985, and<br><br>Amendments to By-Laws adopted by Shareholders on January 14, 1985 are incorporated herein by reference. |
| 4 | Exhibit II Form S-18 Registration Statement No. 2-92949-S is incorporated herein by reference.<br><br>Form 8A Registration Statement, 000-27793, dated October 25, 1999, is incorporated herein by reference. |
| 14 | Code of Ethics |
| 31.1 | CEO Certification |
| 31.2 | CFO Certification |
| 32.1 | Section 906 Certification, CEO |
| 32.2 | Section 906 Certification, CFO |

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant has caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

By: /s/ T. L. KIRCHNER

T.L. Kirchner, Director/President

(Principal Executive Officer)

Date: March 25, 2009

In accordance with the Exchange Act, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| **Signature** | **Title** | **Date** |
|---|---|---|
| /s/ T.L. KIRCHNER<br>T.L. Kirchner | Director/President | March 25, 2009 |
| /s/ JON CORREIO<br>Jon Correio | Director/Vice President, Finance | March 25, 2009 |

| | | |
|---|---|---|
| /s/ MELVIN BROWN<br>Melvin H. Brown | Director | March 25, 2009 |
| /s/ MICHAEL S. BROWN<br>Michael S. Brown | Director | March 25, 2009 |
| /s/ ROBERT SOUTHWORTH<br>Robert Southworth | Director | March 25, 2009 |
| /s/ JOHN L. SCHOOLEY<br>John L. Schooley | Director | March 25, 2009 |