ELECTRONIC SYSTEMS TECHNOLOGY INC
Form 10-K
March 01, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended: December 31, 2018

o **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: **000-27793**

ELECTRONIC SYSTEMS TECHNOLOGY INC.

(Exact name of registrant as specified in its charter)

Washington	**91-1238077**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
415 N. Quay St., Bldg B1, Kennewick, Washington	**99336**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(509) 735-9092**

Securities registered under Section 12(b) of the Exchange Act:

Title of each class Name of each exchange on which registered

None	N/A

Securities registered under Section 12(g) of the Exchange Act:
Common
(Title of Class)

Indicate by checkmark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by checkmark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 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 filing requirements for the past 90 days. Yes þ No o

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	þ	Smaller reporting company	þ

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

The aggregate market value of the registrant's common stock held by non-affiliates was $1,266,127, based on the reported last sale price of common stock on June 30, 2018, which was the last business day of the registrant's most recently completed second fiscal quarter. For purposes of this computation, all executive officers and directors were deemed affiliates.

The number of shares outstanding of the registrant's common stock as of February 4, 2019: 4,946,502 shares.

ELECTRONIC SYSTEMS TECHNOLOGY INC.

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PART I

FORWARD LOOKING STATEMENTS:

When used in this Annual Report and documents incorporated by reference, the terms "anticipates", "believes", "expects" and similar expressions are intended to identify in certain circumstances, forward-looking statements. Such statements are subject to uncertainties and risks that could cause actual results to differ materially from those projected, including the risks described in this Annual Report. Given these uncertainties, readers are cautioned not to place undue reliance on such statements. The Company also undertakes no obligation to update those forward-looking statements.

Item 1. Business.

For over 30 years, Electronic Systems Technology, Inc. ("EST", "us", "we", or the "Company") has specialized in the development and manufacturing of digital data (non-voice) radio transceivers for use in industrial wireless networking applications. With reliance on wireless communication in the modern world, the global modernization of industrial control systems now requires the benefits gained by use of wireless technology. EST designs and produces these specialized, hardened products to operate and survive in these difficult conditions.

The Company designs, develops, manufactures and markets the ESTeem® line of industrial wireless products and accessories. The Company's products provide innovative communication solutions for applications not served or underutilized by conventional, commercial grade communication systems. The Company's products are part of the ESTeem® Industrial Wireless Solutions for commercial, industrial, and government arenas both domestically and internationally. The Company's products are marketed through direct sales, sales representatives, and resellers.

The Company was incorporated in the State of Washington in February 1984, and was granted a United States Patent for the "Wireless Computer Modem" in May 1987, and Canadian patent in October 1988. The Company established a "doing business as" or "DBA" structure, based on the Company's registered trade name of ESTeem® Wireless Modems in 2007. The Company continues to provide product improvements and enhancements to incorporate continuing technological developments, in response to customer needs and market opportunities. New opportunities may arise from changes in FCC regulations or technological developments, both of these are reviewed by management to identify both marketability and profitability.

Development efforts during 2018 were focused primarily on software enhancements for the new ESTeem® Horizon Series. These next generation industrial wireless products will improve our networking capability with higher data rates, improved support features and updates to the latest wireless standards.

In an effort to maintain and expand our customer base in the industrial control marketplace, we team with major automation hardware vendors such as Rockwell Automation. 2018 marks the 27th anniversary of our relationship with Rockwell Automation through their Encompass Program. Rockwell Automation has the largest market share in the United States and is a major entity in the world-wide automation and controls market place. The benefit of the Encompass program and similar partnering efforts is increased exposure to markets that would not otherwise be cost effective to have a direct marketing channel presence in.

PRODUCTS AND MARKETS

The Company's ESTeem® industrial wireless products provide communication links between computer networks, network enabled devices and mobile devices without cables. The widespread use of networked computer systems in business, industry and public service and the adoption of mobile devices in all aspects of modern life has created an environment where the wireless network is no longer a convenience but a necessity. As wireless networking proliferates through the modernization of the industrial sector the need for products such as the ESTeem® industrial wireless (specifically designed for rigors of operation in the industrial environment) will be increased dramatically. These wireless networks will be the backbone connections to the Internet for cloud based services such as the upcoming Internet of Things ("IoT") and Industrial Internet of Things ("IIoT").

All of the ESTeem® models come with industry standard Ethernet (Internet) communications ports and legacy serial ports to provide the broadest range of connections for both new and legacy hardware. The combined features such as AES 128 or AES 256 security encryption, self-healing repeaters, Mesh networking, long range operation and outdoor weatherproof cases make the ESTeem® products unique in our market space.

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PRODUCT APPLICATIONS

Some of the major applications and industries in which ESTeem® products are being utilized are as follows:

Water/Wastewater	Mining
Oil/Gas	Industrial Automation

PRODUCT LINES

The Company manufactures ten (10) models of the ESTeem® industrial wireless modems that operate in frequency from 150 MHz to 5.8 GHz and three (3) models for Molex under an agreement dated June 13th, 2017. A wireless modem is a hardware device for sending and receiving data over a radio carrier and is the foundation of our industrial wireless solutions. Each model will fit best in a specific application based upon several factors such as distance, required data rate and Federal Communication Commission ("FCC") licensing requirements. Each wireless network is discussed in detail with the end customer to determine the best overall solution for their application. No single model or frequency band can solve all applications and having a diverse product selection is critical for expanding the customer base. The following is a summary of the products available from the Company:

ESTeem Model	Type	Frequency (MHz)	RF Power (Watts)	RF Data Rate	LOS Range (Miles)	Interface
210M	Narrow Band Licensed	150 to 174	2	64.8 Kbps	15	Ethernet/RS-232
195M	Narrow Band Licensed	150 to 174	4	12.5 Kbps	15	Ethernet/RS-232/422/485
210C	Narrow Band Licensed	450 to 470	2	64.8 Kbps	15	Ethernet/RS-232
195C	Narrow Band Licensed	450 to 470	4	12.5 Kbps	15	Ethernet/RS-232/422/485
195H	Narrow Band Licensed	217 to 220	2	50 Kbps	15	Ethernet/RS-232/422/485
Horizon900	Unlicensed	900	1	72.2 Mbps	10	Ethernet/ RS-232
Horizon2.4	Unlicensed	2400	1	150 Mbps	5-7	Ethernet/ RS-232
Horizon4.9	Licensed	4900	1	72.2 Mbps	5-7	Ethernet/ RS-232
Horizon5.8	Unlicensed	5800		300 Mbps	5-7	Ethernet/ RS-232

			.250 (Dual Stream)			
Edge900	Unlicensed	900	.25	1 Mbps	10	Ethernet/ RS-232

ADDITIONAL PRODUCTS AND SERVICES

The Company offers various accessories to support the ESTeem® products such as antennas, power supplies and cable assemblies. These accessories are purchased from other manufacturers and resold by EST to support the application of ESTeem® industrial wireless modems. The Company provides direct services to customers, such as repair and upgrade of ESTeem® products. To assist in the application of ESTeem industrial wireless modems, the Company also offers professional services, site survey testing, system start-up, and custom engineering services.

RESEARCH AND DEVELOPMENT AND NEW PRODUCTS

The Company's products compete in an environment of rapidly changing technology. This environment results in the necessity of the Company to be continually updating and enhancing existing products, as well as developing new products in order to remain competitive. Research and Development expenditures for new product development and improvements of existing products by the Company for 2018 and 2017 were $179,413 and $252,411. None of the Company's research and development expenses were paid directly by any of the Company's customers. During 2018, the Company contracted and will continue to contract with companies to provide software development and hardware design engineering expertise when required.

Development efforts during 2018 were focused primarily on software enhancements for the ESTeem® Horizon Series, 195 Narrow Band and 210 Series. These enhancements were developed based on customer needs. The Company plans continued research and development expenditures for development and improvement projects, as they are deemed necessary.

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MARKETING, CUSTOMERS AND SUPPORT

The majority of the Company’s products sold during 2018 were through the reselling efforts of non-exclusive, non-stocking distributors and resellers of the Company’s products, with the remainder of the Company’s sales distributed directly from the Company’s facility through direct sales to end-users of the ESTeem® products. Customers generally place orders on an "as needed basis". Shipping of products is generally completed 1 to 15 working days after receipt of a customer order, with the exception of ongoing, scheduled projects, and custom designed equipment for specific customer applications. As of December 31, 2018, the Company had a sales order backlog of $3,780.

During 2018, the Company continued advertising in trade publications specifically targeting industrial automation systems. There are approximately twenty major automation hardware manufacturers worldwide. The Company has maintained active attendance at tradeshows targeted toward the customers and markets in which it sells products. During 2018, the Company employed sales managers and product support personal to concentrate marketing efforts in the United States automation markets. During 2019, the Company intends to continue targeting domestic and foreign industrial automation markets. The Company maintains an internet web site to provide access to product and technical information for both present and potential customers of the Company’s products. Due to existing reseller relationships, the Company has not implemented an electronic commerce internet website. The Company provides technical support and service for ESTeem® products through phone support, field technicians and internet sources. The Company believes high quality customer support is necessary and vital to differentiate ourselves in the industrial wireless modem market. To maintain a high level of customer support the Company has in the past, and will continue in the future, to make investments and expenditures in support of its customer service programs.

During the year ended December 31, 2018, one customer’s sales accounted 10% or more of total sales revenues. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Financial Statements”.

COMPETITION

The Company’s competition varies according to the market in which the Company's products are competing. All of the markets in which the Company’s products are sold are highly competitive. Listed below are the markets in which the Company’s products compete and major competitors in those markets:

Major Market	Major Competitors
Industrial Automation	FreeWave Technologies, GE/Microwave Data Systems, Prosoft Technology and Cal Amp.

Computer networking, inter and intra building, and remote internet access.	Cisco, Digital Wireless, D-link, Linksys, P-Com and Proxim

Management believes the ESTeem® products compete favorably in the market because of product choices, performance, price, and adaptability of the products to a wide range of applications. The Company's major limitation in competing with other manufacturers is its limited marketing budget, which currently limits the Company’s nationwide advertising and sales force presence.

PATENTS, TRADEMARKS, AND PROPRIETARY INFORMATION

EST was granted a United States patent in 1987 for a "Wireless Computer Modem". In 1988, EST was granted a Canadian patent for a "Wireless Computer Modem". Both patents had lives of 17 years and have expired. The Company’s rights to the ESTeem® Wireless Modem trademark, in uninterrupted use by the Company since 1985, were renewed in 2014. To protect the Company against unauthorized disclosure of proprietary information belonging to the Company, all employees, dealers, distributors, original equipment manufacturers, sales representatives and other persons having access to confidential information regarding Company products or technology are bound by non-disclosure agreements.

GOVERNMENT REGULATION

For operation in the United States, the ESTeem® industrial wireless products require FCC type acceptance. The FCC type acceptance is granted for devices, which demonstrate operation within mandated and tested performance criteria. All of the Company’s products requiring FCC type acceptance have been granted such acceptance. All of the Company’s current ESTeem® production models have also been granted type acceptance in Canada.

The ESTeem® industrial wireless products that operate in the FCC licensed frequency band require licensing under Part 90 of the FCC Rules and Regulations, which must be applied for by the end user of the Company's products. The Company cannot guarantee customers will receive FCC licenses in the frequency spectrum for any particular application. The Company provides information to customers to assist in the application for FCC consumer licenses.

At the time of this filing the Company is unaware of any existing or proposed FCC regulation that would have a materially adverse effect on the Company's operations, but there can be no assurance that future FCC regulations will not have materially adverse effects on the operations of the Company.

SOURCE OF SUPPLY AND MANUFACTURING

The Company purchases certain components necessary for the production of the ESTeem® products from sole suppliers. Components including those manufactured by Hitachi, Motorola Corporation, Mitsubishi, Murata Corporation, Rakon, Toko America Inc. and Triquint, as purchased through a number of distributors, supply key components for the Company's products. The components provided by these and other companies could be replaced or substituted by other products, if it became necessary to do so. If this action occurred, a material interruption of production and material cost expenditures could take place during the process of locating and qualifying replacement components.

Approximately 24% of the Company's inventory at December 31, 2018 consisted of parts having lead times ranging from 12 to 30 weeks. Some parts are maintained at high levels to assure availability to meet production requirements, and accordingly, account for a significant portion of the Company's inventory value. Based on past experience with component availability, distributor relationships, and inventory levels, the Company does not foresee shortages of materials used in production. However, developments in the electronic component marketplace, involving components used by the Company which are also used in cellular phones, personal technology devices and other technology devices, have the potential of creating negative availability and delivery issues for components used by the Company. The Company has been able to procure parts on a timely basis as of the date of this report, however procurement cannot be guaranteed in the future. If shortages were to occur, material interruption of production and product delivery to customers could occur.

The Company contracts with multiple companies, for manufacturing of sub-assemblies and some engineering assistance services for the Company's products. By contracting with these companies, the Company is able to avoid staff fluctuations associated with operating its own manufacturing operation and reduced capital investments in specialized manufacturing equipment. Management reviews the costs for the services provided by these companies and regularly submits Requests for Quotes (RFQ) to multiple suppliers of these operations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations", and "Financial Statements".

ACCESS TO COMPANY INFORMATION

The Registrant does not issue annual or quarterly reports to security holders other than the annual Form 10-K and quarterly Forms 10-Q as electronically filed with the Securities and Exchange Commission ("SEC"). Electronically filed reports may be accessed at www.sec.gov or via the Company's website at www.esteem.com. We make available on our website such reports as soon as reasonably practicable after such reports are electronically filed with or furnished to the SEC.

EMPLOYEES

As of December 31, 2018, the Company employed a staff of 9 persons on a full-time basis, 2 in sales/marketing, 1 in technical support, 5 in engineering/manufacturing, and 1 in finance and administration. There were no significant changes to key personnel in 2018. Michael Eller was appointed as the Company's President and Chief Accounting Officer on February 1, 2016. The Company's operations are dependent upon key members of its engineering and management personnel. In the event services of these key individuals were lost to the Company, adverse effects on the Company's operations may be realized.

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Item 1A. Risk Factors.

Our common stock value and our business, results of operations, cash flows and financial condition are subject to various risks, including, but not limited to those set forth below. If any of the following risks actually occurs, our common stock, business, results of operations, cash flows and financial condition could be materially adversely affected. These risk factors should be carefully considered together with the other information in this Annual Report on Form 10-K, including the risks and uncertainties described under the heading "Forward-Looking Statements." If any of the events described in the risk factors below actually occur, our business, financial condition or results of operations could suffer significantly. In such case, the value of your investment could decline and you may lose all or part of the money you paid to buy our common stock.

We cannot predict whether we will be able to sustain revenue growth, profitability or positive cash flow. Our products are sold in highly competitive markets. Our revenues and operating results can be negatively affected by technology changes in our markets, economic conditions in our markets, and the level of competition in our markets.

Our marketing efforts may be unsuccessful due to limited marketing and sales capabilities. Our limited national advertising and sales coverage may result in the markets in which our products compete not being fully penetrated. The lack of market penetration may result in an adverse effect on our sale revenues. We must continue to develop and maintain appropriate marketing, sales, technical, customer service and distribution capabilities, or enter into agreements with third parties to provide these services to successfully market our products. A failure to develop these capabilities or obtain third-party agreements could adversely affect us.

We may be unable to produce products for sale if we are unable to obtain component materials. Our products require highly specialized components, which are subject to rapid obsolescence, limited availability and design change. Many of components of our products are also used in cellular phone, pagers and other technology devices. If we cannot obtain material to produce products for sale our sales revenues will be negatively impacted.

Our success depends on our ability to retain key management personnel. The success of our Company depends in large part on our ability to attract and retain highly qualified management, administrative, manufacturing, sales, and research and development personnel. Due to the specialized nature of our business, it may be difficult to locate and hire qualified personnel. Our success is significantly dependent on the performance and continued service of key members of Management, such as Chief Executive Officer, Michael Eller, and certain other key employees. If the services of any members of Management become unavailable for any reason, our business and prospects could be adversely affected. Although we have been successful in retaining highly capable and qualified management in the past, there can be no assurance that we will be able to do so in the future.

We may be adversely affected by government regulation. The Federal Communication Commission (FCC) governs use of the products we sell. If the FCC were to implement rules detrimental to our products and the markets in which they are offered our operations would be negatively impacted.

Rapid technological changes in our industry may adversely affect us if we do not keep pace with advancing technology. The wireless communication market is characterized by rapidly advancing technology. Our success depends on our ability to keep pace with advancing technology, processes and standards, such as cellular telephone based technology. We intend to continue to develop and enhance our products to meet perceived market opportunities. However, our development efforts may be rendered obsolete by research efforts and technological advances made by others, and devices other than those we currently produce may prove more advantageous.

We have material weaknesses in our internal controls which may result in us not being able to prevent or detect a material misstatement of our financial statements, which could harm our business and result in regulatory scrutiny. Pursuant to the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 ("Section 404"), Management conducted an assessment of the effectiveness of our internal controls over financial reporting for the year ending December 31, 2018. We determined that there continues to be 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, 2018. We have not maintained effective controls to ensure appropriate segregation of duties due to our limited number of employees in finance and administration. The same employee is responsible for the initiating and recording of transactions, thereby creating segregation of duties weaknesses. Due to this weakness and absence of sufficient mitigating controls, we determined that this control deficiency resulted in a more than remote likelihood that material misstatement or lack of disclosure within the annual or interim financial statements will not be prevented or detected. Avenues for mitigating our internal control weaknesses have been evaluated but mitigating controls have been deemed to be impractical and prohibitively costly due to the size of our organization at the current time. The material weakness in our internal controls may subject us to regulatory scrutiny with undetermined consequences.

The market for our common stock is limited and our shareholders may have difficulty reselling their shares when desired or at attractive market prices. Our stock price and our listing may make it more difficult for our shareholders to resell shares when desired or at attractive prices. Our Company stock trades on the "over-the-counter" market and is listed on OTCQB tier of the OTC Markets bulletin board. Our 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 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

EST does not own any real property, plants, mines, or any other materially important physical properties. The Company's administrative offices, inventory and laboratories are located in leased facilities at 415 N. Quay Street, Bldg. B1, Kennewick, Washington. The Company leases approximately 8,600 square feet of office and laboratory space by a lease agreement with the Port of Kennewick in Kennewick, Washington. As of December 31, 2018, the total monthly lease cost, including tax, is $5,542. The lease covers a period of three years, expiring September 2020.

The Company also owns miscellaneous assets, such as computer equipment, laboratory equipment, and furnishings. The Company does not have any real estate holdings or investments in real estate. The Company maintains insurance in such amounts and covering such losses, contingencies and occurrences that the Company deems adequate to protect its property. Insurance coverage includes a comprehensive liability policy covering legal liability for bodily injury or death of persons, and for property owned by, or under the control of the Company, as well as damage to the property of others. The Company also maintains fidelity insurance which provides coverage to the Company in the event of employee dishonesty.

Item 3. Legal Proceedings.

No proceedings are identified which involve a claim for damages against the Company.

Item 4. Mine Safety Disclosure.

Not Applicable

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

There is no established market for trading the common stock of the Company. The common stock is not regularly quoted in the automated quotation system of a registered securities system or association. The common stock of the Company is traded on the "over-the-counter" market and is listed on OTCQB tier of the OTC Markets bulletin board under the symbol of "ELST". The following table sets forth the high and low sale prices of the Company's common stock for the quarterly period indicated for the last two (2) fiscal years.

The above data was compiled from information obtained from the OTC Bulletin Board quotation service.

(1) The above quotations reflect inter-dealer prices, without retail mark-up, markdown or commission and may not necessarily represent actual transactions. The closing price for our common stock on the OTCQB was $0.38 on February 1, 2019.

The number of holders of record of common stock of the Registrant as of February 4, 2019 was 342 persons/entities with an unknown number of additional shareholders who hold shares through brokerage firms.

Our independent stock transfer agent is Corporate Stock Transfer, Inc. at 320 Cherry Creek Drive South, Suite 435, Denver CO 80209.

The Company does not maintain any form of Equity Compensation Plan.

Stock Repurchases

On January 13, 2016, the Company's Board of Directors approved a resolution authorizing the repurchase of up to $100,000 of the Company's common stock at the price of $0.38 per share. The Company's share repurchase program does not obligate it to acquire any specific number of shares. On March 2, 2016 the Company's Board of Director approved a resolution authorizing the repurchase of an additional $150,000 of the Company's common stock at the price of $0.38 per share. Under the program (the "Stock Repurchase Plan"), shares may be repurchased in open market transactions, complying with Rule 10b5-1 and Rule 10b-18 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Shares repurchased are retired.

The following table shows the Company's activity and related information for the year ended December 31, 2018 under the Stock Repurchase Plan.

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ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
January 1, 2017-January 31, 2017	98,764	$0.38	98,764	559,130
February 1, 2017-February 28, 2017	-0-	-0-	-0-	559,130
March 1, 2017-March 31,2017	7,725	$0.38	106,489	551,405
April 1, 2017-April 30, 2017	45,601	$0.38	152,090,	505,804
May 1, 2017-June 30, 2017	-0-	-0-	-0-	505,804
July 1, 2017-July 31, 2017	8,642	$0.38	160,732	497,162
August 1, 2017-August 31, 2017	11,887	$0.38	172,619	485,275
September 1, 2017-December 31, 2017	-0-	-0-	-0-	485,275
January 1, 2018 – November 31, 2018	-0-	-0-	-0-	485,275
December 1, 2018 – December 31, 2018	300	$0.38	172,919	484,975
Total	172,919	$0.38	172,919	484,975

Item 6. Selected Financial Data.

We are a “smaller reporting company” as defined by Regulation S-K and as such, are not providing the information contained in this item pursuant to Regulation S-K.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Management's discussion and analysis is provided as supplement to, and is intended to be read in conjunction with the Company's audited financial statements and the accompanying integral notes ("Notes") thereto. The following statements may be forward-looking in nature and actual results may differ materially.

RESULTS OF OPERATIONS

GENERAL: The Company specializes in the manufacturing and development of data radio products. The Company offers product lines which provide innovative communication solutions for applications not served by existing conventional communication systems. The Company offers product lines in markets for process automation in commercial, industrial and government arenas domestically as well as internationally. The Company markets its products through direct sales, sales representatives, and domestic, as well as foreign, resellers. Operations of the Company are sustained solely from revenues received through sales of its products and services.

FISCAL YEAR 2018 vs. FISCAL YEAR 2017

GROSS REVENUES: Total revenues for the fiscal year 2018 were $1,395,030 reflecting a decrease of 2.1% from $1,425,128 in gross revenues for fiscal year 2017. During the year ended December 31, 2018, one customer's sales accounted for more than 10% of the total sales revenues. The decrease in total revenues is the result of decreased Engineering Services during 2018. Domestic Sales for the fiscal year were $1,298,447 compared to $1,198,674 in 2017. Sales to Foreign Customers for the fiscal year were $96,583 compared to $226,454 in 2017. Product sales increased to $1,374,810 in 2018, as compared to 2017 sales of $1,358,203, reflecting an increase of 1.2%. Management believes the increase in sales revenues is the result of increased product sales for the Company's Domestic sales segments, specifically industrial automation.

Interest revenues during 2018 increased to $18,097 from 2017 level of $11,411 due to the increased interest rates for the certificates of deposit held by the Company.

As of December 31, 2018, the Company had sales backlog of $3,780. The Company's customers generally place orders on an "as needed basis". Shipment of the Company's products is generally completed within 1 to 15 working days after receipt of customer orders, with the exception of ongoing, scheduled projects, and custom designed equipment for specific customer applications.

COST OF SALES: Cost of Sales, as a percentage of net sales, was 48% and 45% respectively, for 2018 and 2017. Cost of Sales variances are the result of differences in the product mix sold and occurrences of obsolete inventory expense, as well as differences in the price discounting structure for the mix of products sold during the period.

INVENTORY: The Company's year-end inventory values for 2018 and 2017 were as follows:

	2018	2017
Parts	$133,809	$143,452
Work in progress	243,081	201,526
Finished goods	338,105	417,539
TOTAL	$714,995	$762,517

The Company's objective is to maintain inventory levels as low as possible to provide maximum cash liquidity, while at the same time meet production and delivery requirements.

OPERATING EXPENSES: Operating expenses decreased to $853,628 in 2018, from 2017 levels of $996,888. Material changes in expenses are comprised of the following components: Wages/Payroll Taxes/Benefits $129,019, Travel, Professional and Purchased Services decreased by $8,225 and $11,453 respectively. Depreciation expense decreased during 2018 to $11,076 from 2017 levels of $19,939 due to the Company’s decreased capital purchases.

FISCAL YEAR 2017 vs. FISCAL YEAR 2016

GROSS REVENUES: Revenues, for the fiscal year 2017 were $1,425,128 reflecting a decrease of 4% from $1,489,889 in revenues for fiscal year 2016. During the year ended December 31, 2017, no one customer's sales accounted for more than 10% of the total sales revenues. The decrease in total revenues is the result of decreased Engineering Services during 2017. Domestic Sales for the fiscal year were $1,198,674 compared to $1,219,493 in 2016. Sales to Foreign Customers for the fiscal year were $226,454 compared to $270,396 in 2016. Product sales decreased to $1,358,203 in 2017, as compared to 2016 sales of $1,379,530, reflecting a decrease of 1.5%. Management believes the decrease in sales revenues is the result of decreased product sales for the Company's foreign sales segments, specifically industrial automation.

Interest revenues during 2017 decreased to $11,411 from 2016 level of $11,923 due to the use of cash in operations.

As of December 31, 2017, the Company had sales backlog of $6,677. The Company's customers generally place orders on an "as needed basis". Shipment of the Company's products is generally completed within 1 to 15 working days after receipt of customer orders, with the exception of ongoing, scheduled projects, and custom designed equipment for specific customer applications.

COST OF SALES: Cost of Sales, as a percentage of net sales, was 45% and 45% respectively, for 2017 and 2016. Cost of Sales variances are the result of differences in the product mix sold and occurrences of obsolete inventory expense, as well as differences in the price discounting structure for the mix of products sold during the period.

INVENTORY: The Company's year-end inventory values for 2017 and 2016 were as follows:

	2017	2016
Parts	$143,452	$185,911
Work in progress	201,526	216,859
Finished goods	417,539	300,377
TOTAL	$762,517	$703,147

The Company's objective is to maintain inventory levels as low as possible to provide maximum cash liquidity, while at the same time meet production and delivery requirements.

OPERATING EXPENSES: Operating expenses decreased to $996,888 in 2017, from 2016 levels of $1,041,041 primarily due to decreased non-wage expenses and depreciation during 2017. Material changes in expenses are comprised of the following components: Travel, Professional and Purchased Services decreased by $8,762 and $23,610 respectively. Depreciation expense decreased during 2017 to $19,939 from 2016 levels of $26,290 due to the Company's decreased capital purchases. Advertising expenses increased to $9,832 for 2017, compared to $9,552 for 2016, Materials and Supplies expense decreased during 2017 to $9,583 from 2016 levels of $23,965 due to decreased research and development related projects during 2017.

LIQUIDITY AND CAPITAL RESOURCES

The Company's revenues and expenses resulted in a net loss of $116,099 for 2018, decreased from a net loss of $447,855 for 2017. The decrease in net loss is the result of reduced operating expenses and the impact establishing a full valuation allowance against Deferred Tax Asset in 2017. At December 31, 2018, the Company's working capital was $1,932,803 compared with $2,037,947 at December 31, 2017. The Company's operations rely solely on the income generated from sales. The Company's major capital resource requirements are payment of employee salaries and benefits and maintaining inventory levels adequate for production. Extended availability for components critical for production of the Company's products, ranging from 12 to 30 weeks, require the Company to maintain high inventory levels. It is management's opinion that the Company's working capital as of December 31, 2018 is adequate for expected resource requirements for the next twelve months.

The Company's current asset to current liability ratio at December 31, 2018 was 20.8:1 compared to 46.5:1 at December 31, 2017. The decrease in current asset ratio is the result of the Company having increased accounts payable for year-end 2018 when compared with year-end 2017. The Company's cash resources at December 31, 2018, including cash and cash equivalent liquid assets, were $1,223,667, compared to cash resources of $1,208,101 at year-end 2017. The increase in cash and cash equivalent liquid assets is the result of reduction of inventory and increased accounts payable. The Company's cash and cash equivalent assets are held in checking, money market funds and Certificates of Deposits. The Company's accounts receivable at December 31, 2018 were $57,156, compared to $98,941 at year-end 2017. Management believes that all Company accounts receivable as of December 31, 2018 are collectible and does not have a reserve for uncollectable accounts.

The Company believes the level of risk associated with customer receipts on export sales is minimal. Foreign shipments are made only after payment has been received or on Net 30 day credit terms to established foreign companies with which the Company has distributor relationships. Foreign orders are generally filled as soon as they are received therefore; foreign exchange rate fluctuations do not impact the Company.

Inventory levels as of December 31, 2018, were $714,995, reflecting a decrease from December 31, 201 levels of $762,517. The decrease in inventory between December 31, 2018 and December 31, 2017, is due to decreased inventory in Finished Goods.

The Company had no capital expenditures during 2018. The Company intends on investing in additional capital equipment as deemed necessary to support development and manufacture of current and future products.

As of December 31, 2018, the Company's current liabilities increased to $97,668, from 2017 year-end levels of $44,788. The increase in current liabilities was impacted by an increase in accounts payable to $71,257 from $18,969 at the end of 2017.

The Company had no off balance sheet arrangements for the year ended December 31, 2018.

Inflation had minimal adverse effect on the Company’s operations during 2018. Minimal adverse effect is anticipated during 2019.

FORWARD LOOKING STATEMENTS: The above discussion may contain forward-looking statements that involve a number of risks and uncertainties. These factors are more fully described in the “Risk Factors” section of Item 1A of this Annual Report on Form 10-K. 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, rapid advances in competing technologies and risk factors that are listed in the Company’s reports filed with the Securities and Exchange Commission.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Not Applicable.

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Item 8. Financial Statements and Supplementary Data.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

FINANCIAL STATEMENTS AND SUPPLIMENTAL SCHEDULE

AND

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

Electronic Systems Technology, Inc.

Opinion on the Financial Statements

We have audited the accompanying balance sheets of Electronic Systems Technology, Inc. (“the Company”) as of December 31, 2018 and 2017, and the related statements of operations, changes in stockholders’ equity and cash flows for the years then ended, and the related notes (collectively referred to as the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Supplemental Information

The supplemental schedule of operating expenses for the years ended December 31, 2018 and 2017 (“the supplemental information”) has been subjected to audit procedures performed in conjunction with the audit of the Company's financial statements. The supplemental information is the responsibility of the Company's management. Our audit procedures included determining whether the supplemental information reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental information. In forming our opinion on the supplemental information, we evaluated whether the supplemental information, including its form and content, is presented in conformity with accounting principles generally accepted in the United States of America. In our opinion, the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a whole.

/s/ DeCoria,Maichel & Teague, P.S.

We have served as the Company’s auditor since 2012.

Spokane, Washington

February 22, 2019

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	2018	2017
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 323,667	$ 208,100
Certificates of deposit	900,000	1,000,000
Accounts receivable	57,156	98,941
Inventories	714,995	762,517
Prepaid expenses	21,353	8,040
Accrued interest receivable	13,300	5,137
Total Current Assets	2,030,471	2,082,735
PROPERTY AND EQUIPMENT – NET	20,368	31,444
TOTAL ASSETS	$ 2,050,839	$ 2,114,179
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 71,257	$ 18,969
Refundable deposits	10,310	3,937
Accrued wages and bonus	2,138	1,960
Accrued vacation pay	11,449	17,720
Other accrued liabilities	2,514	2,202
Total Current Liabilities	97,668	44,788
TOTAL LIABILITIES	97,668	44,788
COMMITMENTS (NOTE 8)	-	-
STOCKHOLDERS' EQUITY		
Common stock - $.001 par value 50,000,000 shares authorized, 4,985,748 and 4,986,048 shares issued and outstanding, respectively	4,986	4,986
Additional paid-in capital	944,040	944,161
Retained earnings	1,004,145	1,120,244
TOTAL STOCKHOLDERS' EQUITY	1,953,171	2,069,391
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 2,050,839	$ 2,114,179

See Notes to Financial Statements.

	2018	2017
SALES – NET	$ 1,395,030	$ 1,425,128
COST OF SALES	675,598	643,414
GROSS PROFIT	719,432	781,714
OPERATING EXPENSES	853,628	996,888
OPERATING LOSS	(134,196)	(215,174)
OTHER INCOME		
Interest income	18,097	11,411
TOTAL OTHER INCOME	18,097	11,411
NET LOSS BEFORE INCOME TAXES	(116,099)	(203,763)
FEDERAL INCOME TAX PROVISION	-	(244,092)
NET LOSS AFTER INCOME TAXES	$ (116,099)	$ (447,855)
BASIC AND DILUTED LOSS PER SHARE	$ (0.02)	$ (0.09)
BASIC AND DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	4,986,005	5,022,184

See Notes to Financial Statements.

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ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	Common Stock		Additional Paid-In	Retained	
	Shares	Amount	Capital	Earnings	Total
BALANCE AT DECEMBER 31, 2016	5,060,903	$ 5,061	$ 972,609	$ 1,568,099	$ 2,545,769
Net loss	-	-	-	(447,855)	(447,855)
Stock repurchased	(74,855)	(75)	(28,448)	-	(28,523)
BALANCE AT DECEMBER 31, 2017	4,986,048	$ 4,986	$ 944,161	$ 1,120,244	$ 2,069,391
Net loss	-	-	-	(116,099)	(116,099)
Stock repurchased	(300)	-	(121)	-	(121)
BALANCE AT DECEMBER 31, 2018	4,985,748	$ 4,986	$ 944,040	$ 1,004,145	$ 1,953,171

See Notes to Financial Statements.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (116,099)	$ (447,855)
Noncash expenses included in loss:		
Depreciation and amortization	11,076	19,939
Deferred income taxes	-	244,092
Decrease (increase) in operating assets:		
Accounts receivable	41,785	(27,739)
Inventories	47,522	(59,370)
Prepaid expenses	(13,313)	365
Accrued interest receivable	(8,163)	1,766
Increase (decrease) in operating liabilities:		
Accounts payable	52,288	3,855
Accrued wages, bonus, vacation and other accrued liabilities	(5,781)	(811)
Refundable deposits	6,373	(590)
Net Cash provided (used) by Operating Activities	15,688	(266,348)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of certificates of deposit	(900,000)	(1,000,000)
Proceeds from maturities of certificates of deposit	1,000,000	1,000,000
Net Cash provided by Investing Activities	100,000	-
CASH FLOWS USED IN FINANCING ACTIVITIES:		
Repurchase of shares	(121)	(28,523)
Net Cash used by Financing Activities	(121)	(28,523)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	115,567	(294,871)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	208,100	502,971

CASH AND CASH EQUIVALENTS AT END OF YEAR	$	323,667	$	208,100

See Notes to Financial Statements.

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ELECTRONIC SYSTEMS TECHNOLOGY, INC.

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.

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® 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 the allowance for doubtful accounts receivable, inventory obsolescence, useful lives of depreciable assets, share-based compensation, and deferred income taxes. Actual results could differ from those estimates.

Concentrations and Credit Risks

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

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.

Revenue Recognition

The Company accounts for revenue in accordance with Accounting Standards Codification (ASC) Topic 606: Revenue from Contracts with Customers. Under Topic 606, a performance obligation is a promise in a contract with a customer to transfer a distinct good or service to the customer. Our contracts with customers contain a single performance obligation, A contract's transaction price is recognized as revenue when, or as, the performance obligation is satisfied.

The Company considers the contractual consideration payable by the customer when determining the transaction price of each contract. Revenue is recorded net of charges for certain sales incentives and discounts, and applicable state and local sales taxes, which represent components of the transaction price. Charges are estimated by us upon shipment of the product based on contractual terms, and actual charges typically do not vary materially from our estimates. Shipping estimates are determined by utilizing shipping costs provided by the various service providers websites based on number of packages, weight and destination. Shipping costs are included in the cost of goods sold as the revenue is captured in total sales.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

NOTES TO FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies - (Continued)

Revenue Recognition - (Continued)

The Company receives payments from customers based on the terms established in our contracts. When amounts are billed and collected before the services are performed, they are included in deferred revenues. The Company does not generally sell its products with the right of return. Therefore, returns are accounted for when they occur and are accepted. 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.

Performance obligations for product sales are satisfied as of a point in time. Revenue is recognized when control of the product transfers to the customer, generally upon product shipment. Performance obligations for site support and engineering services are satisfied over-time if the customer receives the benefits as we perform work and we have a contractual right to payment. Revenue recognized on an over-time basis is based on costs incurred to date relative to milestones and total estimated costs at completion to measure progress.

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. Warranty expenses are immaterial based on the Company's historical warranty experience.

Financial Instruments

The Company's financial instruments are cash, money market funds, and certificates of deposit. The recorded values of cash, money market funds and certificates of deposit approximate their fair values based on their short-term nature.

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of cash and money market funds purchased with original maturities of three months or less.

Allowance for Uncollectible Accounts

The Company uses the allowance method to account for estimated uncollectible accounts receivable. Accounts receivable are presented net of an allowance for doubtful accounts. As of December 31, 2018 and 2017, the Company's estimate of doubtful accounts was zero. 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.

Inventories

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.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

NOTES TO FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies - (Continued)

Reclassifications

Certain prior year amounts have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported statement of operations.

Property and Equipment

Property and equipment is carried at cost. Major betterments are capitalized and de minimis purchases are expensed. 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. When the Company sells or otherwise disposes of property and equipment a gain or loss is recorded in the statement of operations. The cost of improvements that extend the life of property and equipment is capitalized. 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.

Certificates of Deposit

Certificates of deposit with original maturities ranging from one month to twelve months were $900,000 and $1,000,000 at December 31, 2018 and 2017, respectively.

Software Costs

Software purchased and used by the Company is capitalized as property and equipment based on its cost, and amortized over its useful life, usually not exceeding five years.

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.

Income Taxes

The provision (benefit) for income taxes is computed on the pretax income (loss) 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. The Company evaluates positive and negative information when estimating the valuation allowance for deferred tax assets. For tax positions that meet the more likely than not recognition threshold a deferred tax asset is recognized.

Research and Development

Research and development costs are expensed as operating expenses when incurred. Research and development expenditures for new product development and improvements of existing products by the Company for 2018 and 2017 were $179,413 and $252,411, respectively.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

NOTES TO FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies - (Continued)

Advertising Costs

Costs incurred for producing and communicating advertising are expensed as operating expenses when incurred. Advertising costs for the years ended December 31, 2018 and 2017 were $9,403 and $9,832, respectively.

Earnings Per Share

The Company is required to have dual presentation of basic earnings per share ("EPS") and diluted EPS. Basic EPS is computed as net income (loss) divided by the weighted average number of common shares outstanding for the period. Diluted EPS is calculated based on the weighted average number of common shares outstanding during the period plus the effect of potentially dilutive common stock equivalents.

Potentially dilutive common stock equivalents consist of 120,000 and 150,000 stock options outstanding as of December 31, 2018 and 2017, respectively. As of December 31, 2018 and 2017, the potentially dilutive stock options were not included in the calculation of the diluted weighted average number of shares outstanding or diluted EPS as their effect would have been anti-dilutive.

Share-Based Compensation

Share-based payments to employees, including grants of employee stock options, are measured at fair value and expensed in the statement of operations over the vesting period. See Note 7 for additional information. In addition to the recognition of expense in the financial statements, any excess tax benefits received upon exercise of options will be presented as a financing activity inflow rather than an adjustment of operating activity in the statement of cash flows.

Fair Value Measurements

For fair value measurements, the Company maximize s the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company follows a fair value hierarchy based on the level of independent, objective evidence surrounding the inputs used to measure fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Inputs are prioritized into three levels that may be used to measure fair value:

Level 1: Level 1 applies to assets or liabilities for which there are quoted prices in active markets for identical assets or liabilities.

Level 2: Level 2 applies to assets or liabilities for which there are inputs other than quoted prices that are observable for the asset or liability such as quote prices for similar assets or liabilities in active markets; quoted prices for identical assets in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3: Level 3 applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

NOTES TO FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies - (Continued)

At December 31, 2018 and 2017, the Company has no assets or liabilities subject to fair value measurements on a recurring basis.

New Accounting Pronouncements

Accounting Standards Updates Adopted

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09 Revenue Recognition, replacing guidance currently codified in Subtopic 605-10 Revenue Recognition-Overall. The new ASU establishes a new five step principles-based framework in an effort to significantly enhance comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets. In August 2015, the FASB issued ASU No. 2015-14 Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date. ASU No. 2015-14 deferred the effective date of ASU No. 2014-09 until annual and interim reporting periods beginning after December 15, 2017.

We adopted ASU No. 2014-09 as of January 1, 2018 using the modified-retrospective transition approach. The adoption of the update did not impact our existing method of recognizing revenue and had no impact on 2018 or previously issued financial statements. Additional disclosures required by the update have been included in Note 9.

In August 2016, the FASB issued ASU No. 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The update provides guidance on classification for cash receipts and payments related to eight specific issues. The update is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years, with early adoption permitted. The adoption of this update on January 1, 2018 had minimal impact on the Company's financial statements.

Accounting Standards Updates to Become Effective in Future Periods

In February 2016, the issued ASU No. 2016-02 Leases (Topic 842). The update modifies the classification criteria and requires lessees to recognize the assets and liabilities on the balance sheet for most leases. The update is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the potential impact of implementing this update on the financial statements.

In August 2018, the FASB issued ASU No. 2018-13 Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. The update removes, modifies and makes additions to the disclosure requirements on fair value measurements. The update is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the impact of this update on our fair value measurement disclosures.

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

NOTES TO FINANCIAL STATEMENTS

2 . Inventories

Inventories consist of the following:

	2018	2017
Parts	$ 133,809	$ 143,452
Work in progress	243,081	201,526
Finished goods	338,105	417,539
	$ 714,995	$ 762,517

3 . Property and Equipment

Property and equipment consist of the following:

	2018	2017
Laboratory equipment	$ 580,452	$ 580,452
Software purchased	35,028	35,028
Furniture and fixtures	16,310	16,561
Dies and molds	130,176	130,176
	761,966	762,217
Accumulated depreciation and amortization	(741,598)	(730,773)
	$ 20,368	$ 31,444

4 . Income Taxes

For the year ended December 31, 2018, the Company did not have an income tax benefit nor provision because of continuing losses. The Company recognized a deferred income tax provision for the year ended December 31, 2017 of $244,092 when it established a full valuation allowance against deferred tax assets.

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

	2018	2017
Accrued liabilities	$ 2,400	3,700
Inventories	16,400	9,600
Other	1,400	800
Federal income tax credits	66,000	66,000
Net operating loss carryforwards	175,000	160,700
Less valuation allowance	(261,200)	(240,800)
Total deferred tax assets, net	$ 0	$ 0

Realization of the deferred tax asset is dependent on generating sufficient taxable income prior to expiration of the loss carryforwards and the income tax carryforwards. Management determined that it does not believe it is more likely than not that all of the net deferred tax assets will be realized. Therefore, a valuation allowance has been recorded for the full net deferred tax asset at December 31, 2018 and 2017.

4 . Income Taxes - (Continued)

At December 31, 2018, the Company had approximately $66,000 of research and development income tax credits available to reduce federal income taxes in future periods. The credits expire from 2033-2036. In addition, at December 31, 2018, the Company had approximately $835,000 of net operating loss carryforwards, $750,000 of which will expire between 2033 and 2036. The remaining balance of $85,000 will never expire but whose utilization is limited to 80% of taxable income in any future year.