ELECTRONIC SYSTEMS TECHNOLOGY INC
Form ANNLRPT
May 31, 2013

2012 ANNUAL REPORT

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

415 NORTH QUAY STREET, BUILDING B1

KENNEWICK, WA 99336

ELECTRONIC SYSTEMS TECHNOLOGY **2012 ANNUAL REPORT**

To Our Shareholders,

The year 2012 was a positive improvement for Electronic Systems Technology, Inc in contrast with the weak results that were experienced during 2011, with most of the improvement occurring late in the year. Our total revenues for 2012 increased to $2,121,235 compared to 2011 revenues of $1,805,571. Sales revenues for 2012 increased to $2,113,816 from 2011 sales of $1,791,741, reflecting an increase of 18% due to improved domestic sales which we believe were positively impacted by the slow economic recovery in the United States. During 2012 our profitability was also positively impacted by our increased domestic revenues resulting in net income of $24,122, compared with a net loss for 2011 of $129,990.

Our development efforts have been focused on the design of the ESTeem 210 modem which will be the next generation of narrow band high speed licensed products with Ethernet connectivity for the main applications in the fresh water and waste water markets, and the ESTeem 195Ea modem which will be targeted for high speed Ethernet network backbone applications in high noise environments. We hope that both of these innovations will be enthusiastically received in both domestic and international markets and compliment our existing product line.

We move into 2013 ready to face the challenges that will present themselves in our uncertain economy. We remain committed to continuing to provide a unique blend of innovative products and excellent customer support that we have always provided to our customers. On behalf of the Company and our employees, I would like to thank you for your ongoing support.

T.L. Kirchner

President

COMPANY PROFILE

Electronic Systems Technology, Inc. (EST or the Company) specializes in the manufacturing and development of wireless modem products. The Company uses manufacturing, marketing, and research and development efforts to produce and market the Company s line of ESTeem® Wireless Modem products and accessories. The Company s product offerings provide innovative communication solutions for applications not served or underutilized by conventional communication systems. The Company s products are offered in the process automation markets in commercial, industrial, and government arenas both domestically and internationally, as well as domestic markets for public safety communications infrastructure. 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. During the past three years, the Company has continued product improvements and enhancements to incorporate continuing technological developments, and respond to customer needs and market opportunities. Development efforts during 2012 were focused on development of ESTeem 210 which the next generation of narrow band high speed, licensed ESTeem products, and the ESTeem 195Ea product that operates in the 5.8 GHz frequency range for high speed network back haul applications. In an effort to maintain and expand its customer base, specifically focusing on the industrial control marketplace, the Company continues efforts to team with major programmable logic controller (PLC) hardware vendors. During 2012, the Company marketed products for use in Supervisory Control and Data Acquisitions (SCADA) and Industrial Automation.

PRODUCTS AND MARKETS

The Company s ESTeem wireless modem product lines provide wireless communication links between computers, peripherals, and instrumentation controls using radio frequency waves. The widespread use of computer applications in business, industry and public service has created a dynamic environment of automation and networking, requiring constantly expanding amounts of data transfer. Prior to the invention of the ESTeem modem, the majority of data transfers used telephone modems or direct cable connections, both of which have costly side effects. Telephone modems have potentially expensive monthly charges for the use of telephone lines, and direct cable connections can have installation costs as much or more than the cost of the communication system. ESTeem wireless modem products provide a wireless solution for data transfer by eliminating the need for conventional hardwiring and leased phone lines.

All of the ESTeem models (ESTeems) come with industry standard asynchronous or Ethernet communications ports, giving users new dimensions to Local Area Networking . ESTeem modems work on a packet burst communications concept. Packet systems, whether hardwired or radio, share the same principle of operation: data is taken from RS-232C, RS-422, RS-485 asynchronous or Ethernet ports and transmitted in Electronic Packets . Once a packet of data is formed, the packet is transmitted in a "burst," from one ESTeem modem to another ESTeem modem, hence the term "packet burst communications." Internal Digi-Repeater features allow the user to increase operating range by relaying transmission through multiple ESTeems to reach a destination ESTeem. An ESTeem can operate as an operating node, a repeater node, or both simultaneously, for increased flexibility. Secure data communication is provided in the ESTeem products through use of proprietary technology and industry standard techniques.

PRODUCT APPLICATIONS

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

Agriculture	Material Handling
Airport Lighting	Metals
Automotive	Power
Enterprise Networking	Public Safety
Entertainment	Oil/Gas
Factory Floor Networking	Solar Energy
Federal (military)	Water/Wastewater
Marine	Wind Power

PRODUCT LINES

Licensed Narrow Band Products

The Company s licensed, narrow band packet burst radio modems are typically used for commercial, industrial, and public safety applications. Typical indoor and outdoor fixed base and mobile applications include point to point as well as point to multi-point digital data networking. The distance is dependent on the product chosen as shown in the table below. Employing the internal digi-repeater feature in each radio modem can increase the line-of-sight (LOS) distances shown below for each product type.

ESTeem Model	**Type**	**Frequency** (MHz)	**RF Power** (Watts)	**RF Data Rate** (bps)	**LOS Range** (Miles)	**Interface**
192C	Narrow Band Licensed	450 to 470	1 to 5	19.2 K	15	RS-232/422/485
192CHP	Narrow Band Licensed	450 to 470	10, 20, or 30	19.2 K	40-70	RS-232/422/485
192F	Narrow Band Licensed	400 to 420	1 to 5	19.2 K	15	RS-232/422/485
192M		150 to 174	1 to 5	19.2 K	15	RS-232/422/485

	Narrow Band Licensed					
192MHP	Narrow Band Licensed	150 to 174	10, 20, or 30	19.2 K	40-70	RS-232/422/485

Unlicensed Ethernet Spread Spectrum Products

The Company s Ethernet radios are high performance spread spectrum transceivers employing the industry standard, 10baseT, Ethernet connectivity for commercial, industrial and public safety applications operating in the unlicensed 2.4 GHz and 900 MHz frequency spectrum with data transfer rates from 200Kbps to 54 Mbps. Typical installations include data rate critical, point to point, point to multi-point, last-mile bridge data networking and mobile applications for distances of approximately 5 to 7 miles line-of-sight without the use of the digi-repeater option. The high data capability of these products allows them to be used in Video and Voice over Internet Protocol (VoIP) applications.

ESTeem Model	Type	Frequency (MHz)	RF Power (Watts)	RF Data Rate (bps)	LOS Range (Miles)	Interface
195Eg	Unlicensed	2400	1	1-54 M	5-7	Ethernet/Serial
195Ed	Unlicensed	900	.250 to .630	1-54 M	5-7	Ethernet and Serial
195Es	Unlicensed	900	.125 or 1	200K	10	Ethernet and Serial
195Ea	Unlicensed	5800	.250 or 1	6-54M	5-7	Ethernet and Serial
WLANC	Unlicensed	2400	0.3	1-11 M	300-3000 ft.	Ethernet

Licensed Spread Spectrum Products

The Model 195Ep is a high performance, direct sequence spread spectrum transceiver employing the industry standard, 10baseT, Ethernet connectivity, specifically designed to operate on the US Government allocated frequencies in the 4.9 GHz spectrum for Homeland Defense and first responder networks and infrastructures. Typical outdoor applications include point to point and point to multi-point digital data networking for distances to approximately 5 to 7 miles line-of-sight without the use of the digi-repeater option.

ESTeem Model	Type	Frequency (MHz)	RF Power (Watts)	RF Data Rate (bps)	LOS Range (Miles)	Interface
195Ep	Licensed	4900	2	1-54 M	5-7	Ethernet

ADDITIONAL PRODUCTS AND SERVICES

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

PRODUCT DEVELOPMENT

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 2012 and 2011 were $272,335 and $268,530, respectively. None of the Company s research and development expenses were paid directly by any of the Company s customers. During 2012, the Company contracted and will continue to contract with companies to provide software development and hardware design engineering expertise when required.

Development efforts during 2012 were focused on development of ESTeem 210 which is intended to be the next generation of narrow band high speed, licensed ESTeem product, and the ESTeem 195Ea product that operates in the 5.8 GHz frequency range for high speed network back haul applications (e.g. voice and/or data transmission from a cellular site to a switch). The 195Ea product was brought to market in second half of 2012 and the 210 product is expected to be brought to market during the spring of 2013. The Company plans continued research and development expenditures for development and improvement projects, as they are deemed necessary.

MARKETING STRATEGY

The majority of the Company s products sold during 2012 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, 2012, the Company had a sales order backlog of $105,532.

During 2012, the Company continued advertising in trade publications specifically targeted at users of control, instrumentation, and automation systems, as well as domestic public safety entities. The Company s advertising targeted potential users of Programmable Logic Controllers (PLCs). There are approximately twenty major PLC manufacturers worldwide. The Company has maintained active attendance at tradeshows targeted toward the customers and markets in which it sells products. During 2012, the Company employed sales managers concentrating marketing efforts in both domestic and Latin American for industrial automation. During 2013, 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 the highly variable configuration possibilities of the Company s products, as well as 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 its business. 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.

MARKET INFORMATION FOR THE COMPANY S COMMON STOCK

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.

	Sale Price	
	High	Low
2012		
First Quarter	$0.40	$0.32
Second Quarter	0.43	0.15
Third Quarter	0.35	0.25
Fourth Quarter	0.30	0.21
2011		
First Quarter	$0.59	$0.43
Second Quarter	0.69	0.48
Third Quarter	0.60	0.47
Fourth Quarter	0.48	0.37

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

The number of holders of record of common stock of the Registrant as of April 5, 2013 was 381 persons/entities with an unknown number of additional shareholders who hold shares through brokerage firms.

Our independent stock transfer agent is Computershare Investor Services located at 350 Indiana Street, Suite 800, Golden CO 80401.

Electronic Systems Technology Inc. did not pay a dividend during 2012 for 2011. Dividends undertaken by the Company are solely at the discretion of the Board of Directors. Dividend declarations are usually announced at the Annual Meeting.

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 wireless modem 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, and domestically to public safety entities for mobile data computer terminal (MDC) applications. 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 2012 vs. FISCAL YEAR 2011

GROSS REVENUES: Total revenues for the fiscal year 2012 were $2,121,235 reflecting an increase of 17% from $1,805,571 in gross revenues for fiscal year 2011. During the year ended December 31, 2012, one customer s sales accounted for 13.4% of the total sales revenues. No other sales to any single customer comprised 10% or more of total sales revenues. The increase in total revenues is the result of increased domestic product sales during 2012. Product sales increased to $2,113,816 in 2012, as compared to 2011 sales of $1,791,741, reflecting an increase of 18%. Management believes the increase in sales revenues is the result of increased product sales for the Company s domestic sales segments, specifically industrial automation. Management believes the decreased foreign product sales revenues during 2012 are the result of the fragile global economic conditions significantly impacting capital expenditures for projects involving the Company s products having been delayed or cancelled. The Company intends to continue targeting the domestic and foreign industrial control markets. Management remains committed to pursuing existing marketing strategies, however cannot guarantee sustained sales revenues during 2013 in the continued fragile economic conditions that exist globally.

Interest revenues during 2012 decreased to $7,420 from 2011 level of $9,964 due to decreased rates of return received on the Company s investments.

OPERATING SEGMENTS

Segment information is prepared on the same basis that the Company s Management reviews financial information for operational decision-making purposes. The Company s operating segment information is contained in Financial Statements, Notes to Financial Statements, Note 12 Segment Reporting .

Domestic Revenues

The Company s domestic operations represent 78% of the Company s total sales revenues. Domestic operations sell ESTeem modem products, accessories and service primarily through domestic resellers, as well as directly to end users of the Company s products. Domestic revenues increased to $1,648,899 for the year ended 2012, compared to $1,106,182 for the year ended 2011, reflecting an increase of 49%. Management believes the increase in domestic segment product sales revenues during 2012 is the result of increased product sales for the Company s domestic sales segments, specifically in industrial automation. Management believes the increased domestic product sales revenues during 2012 are the result of the improving economic conditions in the United States.

The majority of the Company's domestic product sales for 2012 were used in industrial automation applications. An example of an industrial automation application is a municipal water treatment operation, which employs the ESTeem modem to transmit industrial control information to and from control room areas via a wireless communications infrastructure. It is the opinion of Management that industrial automation applications will continue to provide the largest portion of the Company's revenues in the foreseeable future.

Domestic segment operating profit was $202,853 for 2012 as compared with a segment operating loss of $177,422 for 2011 due to increased sales revenues and expense management during 2012.

Foreign Revenues

The Company s foreign operating segment represents 22% of the Company s total sales revenues. The foreign operating segment is based wholly in the United States and maintains no assets outside of the United States. The foreign operating segment sells ESTeem modem products, accessories and service primarily through foreign resellers, as well as directly to end customers of the Company s products located outside the United States.

During 2012, the Company had $464,917 in foreign export sales, amounting to 22% of sales revenues for the year, compared with foreign export sales of $686,040 for 2011, reflecting a decrease of 32%. Management believes the decrease in foreign segment product sales revenues during 2012 is the result of the fragile global economic conditions. Products purchased by foreign customers were used primarily in industrial automation applications. Management believes the majority of foreign export sales are the results of the Company s Latin American sales staff, EST foreign reseller activity, and the Company s internet website presence.

Operating income for the foreign segment decreased to $124,402 for 2012 as compared with $269,458 for 2011 due to decreased segment operating sales revenues during 2012 when compared with 2011.

Unallocated Corporate

Unallocated corporate expenses relate to functions, such as accounting, corporate management and administration that support but are not attributable to the Company s domestic or foreign operating segments, including salaries, wages and other expenses related to the performance of these support functions. Unallocated corporate expenses decreased to $278,249 during 2012, compared with $279,489 for 2011, and represented expense to total net revenue percentage of 13% and 15% for 2012 and 2011, respectively.

As of December 31, 2012, the Company had sales backlog of $105,533. 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 44% and 45% respectively, for 2012 and 2011. 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 2012 and 2011 were as follows:

	2012	2011
Parts	$237,848	$228,012
Work in progress	117,695	74,992
Finished goods	146,413	168,310
TOTAL	$501,956	$471,314

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. Approximately 18% of the Company s inventory at December 31, 2012 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, pagers and other personal 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. Inventory levels increased between December 31, 2012 and December 31, 2011, due to increased product sales by the Company during that period and securing components needed to begin manufacture of the new 210C modem.

OPERATING EXPENSES: Operating expenses decreased to $1,149,226 in 2012, from 2011 levels of $1,195,051 primarily due to decreased salaries and expense management during 2012. Material changes in expenses are comprised of the following components: Payroll, Payroll Taxes and Benefits decreased by $30,225. Depreciation expense decreased during 2012 to $15,484 from 2011 levels of $21,956 due to the Company s decreased depreciable assets and decreased capital purchases. Professional services increased to $164,089 from 2011 levels of $160,213 due to increased spending on subcontracted engineering expertise 2012. Advertising expenses increased to $16,116 for 2012, compared to $12,021 for 2011, Materials and Supplies expense increased during 2012 to $25,121 from 2011 levels of $19,355 due to increased research and development related projects during 2012.

FISCAL YEAR 2011 vs. FISCAL YEAR 2010

GROSS REVENUES: Total revenues for the fiscal year 2011 were $1,805,571 reflecting a decrease of 19% from $2,241,655 in gross revenues for fiscal year 2010. The decrease in total revenues is the result of decreased domestic product sales during 2011. Product sales decreased to $1,791,741 in 2011, as compared to 2010 sales of $2,228,798, reflecting a decrease of 20%. Management believes the decrease in sales revenues is the result of decreased product sales for the Company s domestic sales segments, specifically MDC applications and industrial automation. Management believes the decreased domestic product sales revenues during 2011 are the result of the tenuous economic recovery in the United States significantly impacting capital expenditures for projects involving the Company s products having been delayed or cancelled. Management believes the Company s MDC product sales have been negatively impacted by lack of federal funding for projects involving the Company s products and competition from cellular telephone based technology alternatives. Management expects minimal MDC sales revenues during 2012 and therefore intends to have reduced marketing efforts for that specific market moving forward. Due to the continued reduction in MDC product sales, the Company released the sales manager focusing on that market late in 2011. The

Company intends to continue targeting the domestic and foreign industrial control markets. Management remains committed to pursuing existing marketing strategies, however cannot guarantee sustained sales revenues during 2012 in the continued tenuous economic environment that exists in the United States.

Interest revenues during 2011 decreased to $9,664 from 2010 levels of $12,857 due to decreased rates of return received on the Company s investments.

OPERATING SEGMENTS

Domestic Revenues

The Company s domestic operations represent 62% of the Company s total sales revenues. Domestic operations sell ESTeem modem products, accessories and service primarily through domestic resellers, as well as directly to end users of the Company s products. Domestic revenues increased to $1,105,701 for the year ended 2011, compared to $1,678,803 for the year ended 2010, reflecting a decrease of 34%. Management believes the decrease in domestic segment product sales revenues during 2011 is the result of decreased product sales for the Company s domestic sales segments, specifically MDC applications and industrial automation. Management believes the decreased domestic product sales revenues during 2011 are the result of the tenuous economic recovery in the United States significantly impacting capital expenditures for projects involving the Company s products having been delayed or cancelled. Management believes the Company s MDC product sales have been negatively impacted by lack of federal funding for projects involving the Company s products and competition from cellular telephone based technology alternatives. Due to the continued reduction in MDC product sales, the Company released the sales manager focusing on that market late in 2011. Management expects minimal MDC sales revenues during 2012 and therefore intends to have reduced marketing efforts for that specific market moving forward.

The majority of the Company's domestic product sales for 2011 were used in industrial automation applications. An example of an industrial automation application is a municipal water treatment operation, which employs the ESTeem modem to transmit industrial control information to and from control room areas via a wireless communications infrastructure. It is the opinion of Management that industrial automation applications will continue to provide the largest portion of the Company's revenues in the foreseeable future.

Domestic segment operating loss was $177,422 for 2011 as compared with a segment operating income of $278,572 for 2010 due to decreased sales revenues during 2011.

Foreign Revenues

The Company s foreign operating segment represents 38% of the Company s total sales revenues. The foreign operating segment is based wholly in the United States and maintains no assets outside of the United States. The foreign operating segment sells ESTeem modem products, accessories and service primarily through foreign resellers, as well as directly to end customers of the Company s products located outside the United States.

During 2011, the Company had $686,040 in foreign export sales, amounting to 38% of sales revenues for the year, compared with foreign export sales of $549,995 for 2010, reflecting an increase of 25%. Management believes the increase in foreign segment product sales revenues during 2011 is the result of increased reseller activities in the industrial automation markets in Peru, Mexico and Colombia when compared with 2010. Products purchased by foreign customers were used primarily in industrial automation applications. For 2011 sales to Industrial Controls, a reseller of the company s products in Peru, comprised 11% of the Company s total sales revenues. Management believes the majority of foreign export sales are the results of the Company s Latin American sales staff, EST foreign reseller activity, and the Company s internet website presence.

Operating income for the foreign segment increased to $269,458 for 2011 as compared with $232,331 for 2010 due to increased segment operating sales revenues during 2011 when compared with 2010.

Unallocated Corporate

Unallocated corporate expenses relate to functions, such as accounting, corporate management and administration that support but are not attributable to the Company s domestic or foreign operating segments, including salaries, wages and other expenses related to the performance of these support functions. Unallocated corporate expenses decreased to $279,489 during 2011, compared with $323,880 for 2010, and represented expense to total net revenue percentage of 15% and 14% for 2011 and 2010, respectively.

OPERATING EXPENSES Operating expenses increased to $1,195,051 in 2011, from 2010 levels of $1,185,031 primarily due to increased salaries and engineering expertise related expenses during 2011. Material changes in expenses are comprised of the following components: Bad debt expense decreased to $7,718 due to higher than normal bad debt expense from amounts not paid by the Company s customer Schwager Davis, experienced during 2010. Depreciation expense decreased during 2011 to $21,956 from 2010 levels of $32,365 due to the Company s decreased depreciable assets and decreased capital purchases. Professional services increased to $160,213 from 2010 levels of $137,745 due to increased spending on subcontracted engineering expertise 2011. Salaries, benefits and related taxes increased to $1,081,308 in 2011, from 2010 levels of $1,044,198, due to the Company ending salary reduction measures that were implemented during 2010. Travel expenses decreased to $81,868 for 2011, compared to $85,136 for 2010, due to slightly reduced sales and customer support related activities when compared with 2010. Materials and Supplies expense increased during 2011 to $19,355 from 2010 levels of $14,277 due to increased research and development related projects during 2011.

LIQUIDITY AND CAPITAL RESOURCES

The Company s revenues and expenses resulted in a net profit of $24,123 for 2012, increased from a net loss of $129,990 for 2011. The increase in profitability is the result of increased sales revenues and increased operating expenses when compared with 2011. At December 31, 2012, the Company's working capital was $2,878,075 compared with $2,813,213 at December 31, 2011. 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, 2012 is adequate for expected resource requirements for the next twelve months.

The Company's current asset to current liability ratio at December 31, 2012 was 64.0:1 compared to 29.1:1 at December 31, 2011. The increased in current asset ratio is the result of the Company having reduced customer deposits for year-end 2012 when compared with year-end 2011. The Company's cash resources at December 31, 2012, including cash and cash equivalent liquid assets, were $818,497, compared to cash resources of $1,227,490 at year-end 2011. The decrease in cash and cash equivalent liquid assets is the result of timing differences in certificate of deposit maturities and receivable collection cycles when compared with year-end 2011. The Company s cash and cash equivalent assets are held in checking and money market investment accounts.

The Company's accounts receivable, adjusted for allowance for uncollectible accounts, at December 31, 2012, were $195,482, compared to $104,166 at year-end 2011. Management believes that all Company accounts receivable as of December 31, 2012 are collectible and has reduced the reserve for uncollectable account to $0.

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, 2012, were $501,956, reflecting an increase from December 31, 2011 levels of $471,314. The increase in inventory between December 31, 2011 and December 31, 2012, is due to increased product sales by the Company during 2012.

The Company had capital expenditures of $3,398 during 2012 primarily for manufacturing related instrumentation. 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, 2012, the Company's current liabilities decreased to $45,701, from 2011 year-end levels of $100,114. The decrease in current liabilities is the result of the Company s decreased refundable deposit liability of $2,229 when compared with refundable deposits liability of $49,303 for year-end 2011.

The Company had no off balance sheet arrangements for the year ended December 31, 2012.

Inflation had minimal adverse effect on the Company s operations during 2012. Minimal adverse effect is anticipated during 2013.

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 the 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.

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 Principle Accounting Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as such terms are defined under Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Exhange Act) 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, 2011.

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, 2012 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. Management, under the supervision and with the participation of the Company s Chief Executive Officer and Principal Accounting Officer, assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2012 and concluded that it is ineffective in assuring that the financial reports of the Company are free from material errors or misstatements. The material weakness is as follows:

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

Management s Remediation Initiatives

This Annual Report does not include an attestation report of the Company s registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by the Company s registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the Company to provide only Management s report in this Annual Report.

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

14

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

FINANCIAL STATEMENTS

AND

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

TABLE OF CONTENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors

Electronic Systems Technology, Inc.

We have audited the accompanying balance sheet of Electronic Systems Technology, Inc. (the Company) as of December 31, 2012 and the related statement of operations, changes in stockholders equity and cash flows for the year then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Electronic Systems Technology, Inc. as of December 31, 2012, and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule of operating expenses is presented for purposes of additional analyses and is not a required part of the basic financial statements. The supplemental schedule presented has been subjected to the auditing procedures applied in the examination of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

DeCoria, Maichel & Teague, P.S.

Spokane, Washington

March 26, 2013

Moe O Shaughnessy & Associates, P.S.

Certified Public Accountants

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To The Board of Directors and Stockholders of

Electronic Systems Technology, Inc.

Kennewick, WA

We have audited the accompanying balance sheets of Electronic Systems Technology, Inc., dba ESTeem Wireless Modems, as of December 31, 2011 and 2010, and the related statements of operations, stockholders equity and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Electronic Systems Technology, Inc., as of December 31, 2011 and 2010, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules of operating expenses and selected financial data are presented for purposes of additional analyses and are not a required part of the basic financial statements. Such supplemental schedules have been subjected to the auditing procedures applied in the examination of the basic financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

/s/ Moe O Shaughnessy & Associates, P.S.

Spokane, Washington

February 23, 2012

427 W. Sinto Avenue, Ste. 200, Spokane, Washington 99201

Phone (509) 325-4900 Fax (509) 325-9345 E-Mail moaps@moaps.net

ELECTRONIC SYSTEMS TECHNOLOGY, INC.

DBA ESTEEM WIRELESS MODEMS

BALANCE SHEETS

DECEMBER 31, 2011 AND 2010

		2012	201
TS			
ENT ASSETS			
		$ 117,429	
ey market investment		701,068	1,1
ficates of deposit		1,367,000	1,0
unts receivable, net of allowance for			
btful accounts of $-0- and $787, respectively		195,482	1
tories		501,956	4
id insurance		10,932	
id expenses		28,207	
ued interest receivable		1,703	
ral income tax refund receivable		-	
al Current Assets		2,923,777	2,9
ERTY AND EQUIPMENT NET		42,272	
SITS		1,675	
RRED INCOME TAX ASSET		26,000	
L ASSETS		$ 2,993,724	3,0
LITIES AND STOCKHOLDERS EQUITY			
ENT LIABILITIES			
unts payable	$	7,517	
ndable deposits		2,229	
ued wages and bonus		3,754	
ued payroll and other taxes		8,156	

ued vacation/DIV>

f Contents

MANAGEMENT

s are appointed annually by the Board and serve at the discretion of the Board. Set forth below is information ng the current executive officers of NaviSite.

	Age	Position
oks Borcherding	43	President and Chief Executive Officer
W. Pluntze	49	Chief Financial Officer and Treasurer
ne Bianchi	46	Chief Marketing Officer
Clayman	41	Senior Vice President of Enterprise Sales
Martin	52	Executive Vice President and Chief Technology Officer
Sabharwal	37	Senior Vice President of Global Delivery
Sinha	52	President of America s Job Exchange, Inc., a NaviSite subsidiary

oks Borcherding has served as our President since March 1, 2010 and as our Chief Executive Officer since 15, 2010. From April 2009 to March 1, 2010, Mr. Borcherding served as our Senior Vice President of Sales ief Revenue Officer of NaviSite. From April 2007 through April 2009, Mr. Borcherding served as the Director egy, Planning and Operations of Cisco Systems, Inc., where he was responsible for strategy, planning, s development and sales operations for its Enterprise East division with a focus on driving revenue. From 2005 through April 2007, Mr. Borcherding served as a practice leader of unified communications at Cisco s, Inc. From August 2004 through March 2005, Mr. Borcherding served as the Global Solutions Director of Inc., a global leader in business communications.

W. Pluntze has served as our Chief Financial Officer and Treasurer since January 2007. Mr. Pluntze first NaviSite in 2002 as a director and as the Chairman of the Audit Committee. From March 2003 until May Mr. Pluntze served as our acting Chief Financial Officer of NaviSite and from May 2005 until January 2007, ntze served as our Senior Vice President of Finance.

ne Bianchi has served as our Chief Marketing Officer since December 2009, which is when Ms. Bianchi first NaviSite. From 2004 to 2009, Ms. Bianchi was Vice President of Marketing at MetaCarta, a pioneer in the ning geo-web space, whose technology allows content to be geographically referenced and searched using a a filter, where she worked extensively with brand leaders like National Geographic and helped propel arta s business in the public sector, publishing and energy markets. MetaCarta was acquired by Nokia. Prior to arta, from 2000 to 2004, Ms. Bianchi was Vice President of Marketing at eCopy, a leader in document tion and enterprise content management solutions which was recently acquired by Nuance. While at eCopy, anchi worked closely with Canon USA to build eCopy s brand and leverage eCopy as a differentiator for the Enterprise Sales organization.

Clayman has served as our Senior Vice President of Enterprise Sales since August 2009. Mr. Clayman first NaviSite in June 2004 as Vice President of Hosting and Chief Information Officer through the acquisition of dge, Inc. From June 2004 through June 2006, Mr. Clayman served as our Senior Vice President of Hosting s. From June 1999 through June 2004, Mr. Clayman served as a Vice President and Chief Information Officer bridge, Inc., a leading application outsourcer.

Martin has served as our Executive Vice President and Chief Technology Officer since 2008. Mr. Martin first NaviSite in 2002 as our Senior Vice President of Corporate Development. Prior to joining NaviSite, rtin managed the national hosting and application services organization for Applied Theory, Inc. As a nder of Applied Theory, Inc., he was instrumental in the development of the company s managed service g by combining traditional hosting services with application development, integration and support services.

Sabharwal has served as our Senior Vice President of Global Delivery since July 4, 2005. Mr. Sabharwal ned NaviSite in September 2004 as Vice President of Global Delivery. From November 2003 through ber 2004, Mr. Sabharwal was Vice President and Managing Director at

f Contents

here Technologies, a leading consulting firm that provides business-focused services and solutions to life s organizations, where he led their global delivery operations.

Sinha has served as President of America s Job Exchange, Inc., a wholly-owned subsidiary of NaviSite, since ber 1, 2009. Mr. Sinha first joined NaviSite in May 2007 as a Senior Vice President and our Chief Marketing . From September 2003 through May 2007, Mr. Sinha was an employee of Monster.com, where he initially as a Vice President of Business Development and then served as the General Manager of the eCommerce n of Monster.com, where he built and expanded the direct to customer channel.

EXECUTIVE COMPENSATION

lowing table sets forth certain information concerning fiscal 2010 and fiscal 2009 compensation of our Named ve Officers.

rdance with new SEC disclosure requirements, the amounts in the Stock Awards and Option Awards columns the grant date fair values of awards made in each such year. The amounts in such columns and the Total for fiscal 2009 have been recalculated to conform to the current requirements and will not match the proxy nts for prior years, which disclosed the value of the equity awards based on accounting expense recognized Company during fiscal 2009.

SUMMARY COMPENSATION TABLE

and Principal Position	Year	Salary ($)	Stock Awards ($)(1)	Option Awards ($)(1)(2)	Non-Equity Incentive Compensation ($)(3)	All Other Compensation ($)	Total ($)
P. Becker(4)	2010	350,000		167,860	254,625		772,485
Chief Executive Officer	2009	350,000			186,900		536,900
oks Borcherding(5)	2010	243,269		125,895	200,417		569,581
nt and Chief Executive							
W. Pluntze	2010	243,000		83,930	105,483		432,413
inancial Officer and	2009	243,000			77,143		320,143
er							
ingale(6)	2010	106,154		142,540		186,245(7)	434,939
General Counsel							

e amounts shown in the Stock Awards and Option Awards columns represent the aggregate grant date fair lue of awards computed in accordance with Financial Accounting Standards Board (FASB) Accounting andards Codification (ASC) Topic 718, not the actual amounts paid to or realized by the Named Executed fficers during fiscal 2010 and fiscal 2009. FASB ASC Topic 718 fair value amount as of the grant date for ock awards and stock options generally is spread over the number of months of service required for the grant vest. An explanation of the vesting of restricted stock awards and options awards, as well as the methodology r performance-based restricted stock payouts, is discussed in the footnotes to the Outstanding Equity Awards 2010 Fiscal Year End table below.

he fair value of each stock option award is estimated as of the date of grant using the Black-Scholes valuation odel. Additional information regarding the assumptions used to estimate the fair value of all stock options vards is included in Note 15 to Consolidated Financial Statements contained in our Annual Report on rm 10-K for fiscal 2010.

mounts in fiscal 2010 were earned under our FY 2010 Executive Management Bonus Program. See FY 2010 xecutive Management Bonus Program below for a discussion of such program. Except as described below, yments are generally made in October of each year, after the GNC Committee determines whether the rformance objectives for the previous plan year have been achieved. Amounts in fiscal 2009 were earned der our FY 2009 Executive Management Bonus Program.

r. Becker resigned as Chief Executive Officer on August 15, 2010.

f Contents

r. Borcherding was promoted to President on March 1, 2010 and to Chief Executive Officer on August 15, 10. In connection with Mr. Borcherding s promotion to President, the GNC Committee increased his annual se salary from $200,000 to $290,000.

r. Zingale began his employment on August 31, 2009 and resigned effective February 5, 2010.

cludes $120,000 of severance payments, $39,112 of earned bonus payments pursuant to his severance reement described under Employment Agreements of Named Executive Officers below, $4,278 for payment unused vacation upon Mr. Zingale s resignation and $22,855, which amount represents the actual amount alized by Mr. Zingale relating to stock options exercised during fiscal 2010.

10 Executive Management Bonus Program

tember 17, 2009, the GNC Committee established our FY 2010 Executive Management Bonus Program **MBP**), creating target cash bonuses for fiscal 2010 for the Named Executive Officers and other senior ves of NaviSite.

ard of a cash bonus to any Named Executive Officer or senior executive pursuant to the 2010 MBP was to the achievement of certain targets for fiscal 2010, including consolidated revenue, bookings and EBITDA iSite and individual performance objectives. EBITDA, for purposes of this bonus program was defined as s before interest, taxes, depreciation and amortization, excluding impairment costs, stock-based nsation, severance, costs related to discontinued operations, and other non-operational charges (**Adjusted A**).

nus which would be made if the targets were met, for the Named Executive Officers, is set forth below:

	Target Bonus
P. Becker	$ 262,500
ks Borcherding	$ 235,000
V. Pluntze	$ 106,920

ssrs. Becker and Pluntze, there was one financial target upon which the 2010 MBP was based: the ement of $31,893,000 of Adjusted EBITDA (the **Target**), in fiscal 2010. For Mr. Becker, 100% of his bonus vas dependent on meeting the Target. For Mr. Pluntze 75% of his bonus target was based on meeting the and 25% was based on meeting individual business objectives, which were (i) providing support on potential les, (ii) developing and implementing a plan for the migration of certain general and administrative activities and (iii) refining the monthly reporting process.

10 MBP was structured so that Messrs. Becker and Pluntze only earned cash bonuses if NaviSite s Adjusted A was at least 75% of the Target. If NaviSite s Adjusted EBITDA was 75% of the Target, then Messrs. Becker ntze would earn a cash bonus equal to 70% of the portion earned based on meeting the Target, plus the earned based on meeting individual business objectives, as applicable. The bonus targets would be earned in y upon 100% achievement of the Target. Between triggering the earning of the cash bonus at the threshold age of 75% and the 100% achievement of the Target, the cash bonus earned would be paid in a linear ship to the achievement of the Target.

. Borcherding, the terms of his bonus target were initially set forth in his employment offer letter dated 27, 2009 and were affirmed by the GNC Committee on September 17, 2009. For the first half of fiscal 2010, of Mr. Borcherding s bonus target, which was set at $325,000, was dependent on achieving new monthly ng revenue bookings at a rate of $1 million per quarter. Mr. Borcherding received his bonus quarterly but it easured on a year-to-date basis for the calculation of on-target earnings. Mr. Borcherding received a pro-rated for performance both below and above his target achievement.

ection with Mr. Borcherding s promotion to President and increase in his base salary on March 1, 2010, the ommittee amended his bonus target and financial targets, effective as of January 31, 2010. Therefore, for the half of fiscal 2010, Mr. Borcherding s bonus target was reduced from $325,000 to $235,000 and 50% of his arget was based on meeting the Target and 50% was based on achieving new

13

f Contents

y recurring revenue bookings at a rate of $894,000 for the fiscal third quarter and $946,000 for the fiscal quarter. For Mr. Borcherding, if NaviSite s Adjusted EBITDA was 75% of the Target, he would earn a cash equal to 70% of the portion earned based on meeting the Target. Between triggering the earning of the cash at the threshold percentage of 75% and the 100% achievement of the Target, the cash bonus earned would be a linear relationship to the achievement of the Target. For the portion based on achieving new monthly ng revenue bookings, Mr. Borcherding continued to receive any bonus earned on such portion quarterly and gible to receive a pro-rated bonus for performance both below and above his target achievement.

ngale also had a target bonus set under the 2010 MBP but his severance agreement as described in oyment Agreements of Named Executive Officers below superseded the 2010 MBP as applicable to him.

yment Agreements of Named Executive Officers

not have agreements with any of the Named Executive Officers which guarantee employment for a set term, cordingly, all of the Named Executive Officers are employees at will. We have entered into certain separation ents with our Named Executive Officers, as discussed in Potential Payments Upon Termination or -In-Control below.

e entered into an indemnification agreement with each of our Named Executive Officers pursuant to which he indemnified by us, subject to certain limitations, for any liabilities incurred by him in connection with his role fficer of NaviSite.

P. Becker

ered into an employment agreement with Arthur P. Becker as of February 21, 2003, pursuant to which he was ed as our chief executive officer and president. His agreement was for a continuous term but could be ted by either party at any time. The employment agreement set forth Mr. Becker s initial compensation terms. gust 15, 2010, Mr. Becker resigned from NaviSite and entered into a separation agreement with NaviSite on ber 21, 2010.

he separation agreement, Mr. Becker, in exchange for signing a general release of claims in favor of NaviSite tain of its affiliates, became entitled to: (i) severance payments totaling $175,000 in equal installments over nths, representing six months of base salary as of the time of his resignation ($350,000); (ii) $254,625, which represents unpaid bonus from the 2010 MBP, which is reflected in the Summary Compensation Table above s earned in fiscal 2010; (iii) $10,788, which amount represents bonus payment equal to his target bonus for e s current fiscal year, pro-rated to the last date of employment; (iv) COBRA payments for up to six months; gnment of NaviSite s office lease for certain premises located at 654 Madison Avenue, New York, New York **ease**); (vi) a payment to landlord under the Lease of $77,216, which amount represents half of the base rent due uch Lease for the period from September 1, 2010 through August 31, 2011; and (vii) an amendment to his ptions and restricted stock grants to provide that, for so long as he remains a member of the Board of e, the awards shall continue to vest and remain exercisable as if his employment were continuing.

ks Borcherding and James W. Pluntze

ered into employment offer letters with each of R. Brooks Borcherding and James W. Pluntze when they nced their employment with NaviSite. These letters generally set forth initial base salary, target bonus and ompensatory matters, such as initial equity grants.

ection with Mr. Borcherding s promotion to President on March 1, 2010, the GNC Committee increased his salary from $200,000 to $290,000. On September 12, 2010, the GNC Committee increased Borcherding s base salary to $320,000 in connection with his appointment as Chief Executive Officer and Pluntze s base salary to $275,000 in light of new responsibilities he assumed.

f Contents

ingale

ruary 5, 2010, Mr. Zingale resigned from NaviSite and entered into a separation agreement with NaviSite as uary 5, 2010. Under the separation agreement, Mr. Zingale, in exchange for signing a general release of in favor of NaviSite and certain of its affiliates, received: (i) severance payments totaling $120,000 in equal nents over six months, representing six months of base salary at the time of his resignation ($240,000); us payments totaling $39,112; (iii) COBRA payments for up to six months; and (iv) an amendment to his ption to accelerate the vesting of 25% of such option.

lowing table details unexercised options and restricted shares that have not vested for each of the Named ve Officers as of July 31, 2010.

OUTSTANDING EQUITY AWARDS AT 2010 FISCAL YEAR END

	Option Awards				Stock Awards			
	Number of Securities Underlying Unexercised Options (#) Exercisable	**Number of Securities Underlying Unexercised Options (#) Unexercisable(1)**	**Option Exercise Price ($)**	**Option Expiration Date**	**Number of Shares or Units of Stock That Have Not Vested (#)**	**Market Value of Shares or Units of Stock That Have Not Vested ($)(2)**	**Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)(3)**	**Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)(2)(3)**
ecker	40,000		2.55	7/9/2013	43,880(4)	125,497	92,333	264,072
	60,000		2.55	7/10/2013				
	400,000		5.41	1/30/2014				
	500,000		1.58	3/31/2015				
	103,125		1.48	2/17/2016				
		100,000	2.48	6/14/2020				
g		75,000	2.48	6/14/2020	112,500(5)	321,750		
	40,000		2.55	7/9/2013	20,250(6)	57,915	40,000	114,400
	40,000		2.55	7/10/2013				
	3,125		2.55	1/30/2014				
	16,875		2.55	9/20/2014				

	80,000		1.58	3/31/2015
	22,500		1.45	2/23/2016
	75,000		4.14	11/27/2016
		50,000	2.48	6/14/2020
ale(7)				

ock option vesting and becoming exercisable with respect to 25% on the six month anniversary of the date of ant (June 15, 2010) and the remainder in 36 equal monthly installments thereafter.

ased on the fair market value of our Common Stock on July 31, 2010 ($2.86 per share).

epresents potential threshold vesting of performance-based restricted stock, which was awarded on July 22, 08. The restrictions lapse as follows (i) for the first 1/3 of the shares, 50% vests upon NaviSite exceeding a arket capitalization of $182,330,695 for 20 consecutive trading days and, so long as the employee remains nployed by NaviSite, the remaining 50% of such 1/3 vests on the one year anniversary thereafter, (ii) for the cond 1/3 of the shares, 50% vests upon NaviSite exceeding a market capitalization of $232,330,695 for 20 nsecutive trading days, and so long as the employee remains employed by NaviSite, the remaining 50% of ch 1/3 vests on the one year anniversary thereafter, and (iii) for the final 1/3 of the shares, 50% vests upon aviSite exceeding a market capitalization of $282,330,695 for 20 consecutive trading days and, so long as the nployee remains employed by NaviSite, the remaining 50% of such 1/3 vests on the one year anniversary ereafter. In the event there is a change of control, which results in a market capitalization: (x) exceeding 82,330,695, then 100% of the first 1/3 of the shares will vest immediately, so long as the employee remains nployed by NaviSite as of such date, with the remainder of the shares being forfeited; (y) exceeding 32,330,695, then 100% of the first and second 1/3 of the shares will vest immediately, so long as the nployee remains employed by NaviSite as of such date, with the remainder of the shares being forfeited; or) exceeding $282,330,695, then 100% of all of the shares will vest immediately, so long as the employee mains employed by NaviSite as of such date. The

15

f Contents

rformance objectives have not been achieved. If the performance objectives are not achieved by the tenth niversary of the date of grant, any unvested portion of such shares of performance-based restricted stock will mediately forfeit to NaviSite.

estricted stock award vesting with respect to 43,880 shares on August 21, 2010.

estricted stock award vesting with respect to approximately 4,166 shares each month beginning on August 13, 10 and ending on October 13, 2012.

estricted stock award vesting with respect to 20,250 shares on August 21, 2010.

r. Zingale resigned from NaviSite effective February 5, 2010. Per an arrangement with NaviSite, NaviSite celerated the vesting of 25% of his option to purchase 100,000 shares of our Common Stock; the remaining % of such option was forfeited to NaviSite on February 5, 2010. Mr. Zingale exercised his option to purchase ,000 shares prior to the end of fiscal 2010.

ial Payments Upon Termination or Change-in-Control

P. Becker and Mark Zingale

Becker and Zingale have each resigned from NaviSite, effective as of August 15, 2010 and February 5, 2010, ively. Each of Messrs. Becker and Zingale entered into separation agreements with NaviSite upon their tion, the details of which are described above under Employment Agreements of Named Executive Officers.

oks Borcherding and James W. Pluntze

31, 2007, we entered into a Separation Agreement with Mr. Pluntze and on April 13, 2009, we entered into a ion Agreement with Mr. Borcherding (together, as amended to date, the **Executive Separation Agreements**). xecutive Separation Agreement provides that if Mr. Borcherding s or Mr. Pluntze s employment is terminated ther than for Cause (as defined below), Disability (as defined below) or death, or by Mr. Borcherding or ntze for Good Reason (as defined below) following a Change of Control (as defined below), then we shall be ed to pay Mr. Borcherding or Mr. Pluntze: (i) as severance his annual base salary in effect on the date of tion for a period of twelve months for Mr. Borcherding and for a period of six months for Mr. Pluntze; (ii) a um bonus payment equal to his target bonus for the current fiscal year pro rated to the date of termination; unpaid bonus from the prior fiscal year; (iv) all legal fees and expenses incurred by Mr. Borcherding or ntze in seeking to obtain or enforce any right provided by the Executive Separation Agreement; and nbursement for COBRA payments for health and welfare benefits continuation if he elects COBRA coverage eriod of six months. Mr. Borcherding will not be entitled to the foregoing benefits if an equivalent benefit is d by him from another employer during the twelve month period following his termination. Mr. Pluntze will entitled to the foregoing benefits if an equivalent benefit is received by him from another employer during the nth period following his termination.

ecutive Separation Agreements also provides that following a Change of Control (as defined below) of e, all options and shares of restricted stock issued to Mr. Borcherding or Mr. Pluntze under our Amended and d 2003 Stock Incentive Plan or any other NaviSite stock incentive plan will become exercisable and vested in the date of the Change of Control. However, the shares of performance-based restricted stock granted to ntze on July 22, 2008 are not subject to any separation or change of control agreement NaviSite currently has e with Mr. Pluntze and will not accelerate in accordance with the provisions of any such separation or change rol agreement. The Executive Separation Agreements are intended to comply with Section 409A of the l Revenue Code of 1986, as amended.

ligation to provide the forgoing benefits is subject to the effectiveness of a general waiver and release from rcherding or Mr. Pluntze in favor of us, our directors, officers, employees, representatives, agents and es in a form satisfactory to us.

f Contents

ions

e means (i) an intentional act of fraud, embezzlement or theft in connection with the executive officer s duties to te or in the course of the executive officer s employment with NaviSite, (ii) his willful engaging in gross duct which is demonstrably and materially injurious to NaviSite, (iii) his willful and continued failure to n substantially his duties with NaviSite or one of its affiliates (other than any such failure resulting from city due to physical or mental illness), which such failure is not cured within five (5) days after a written d for substantial performance is delivered to the executive officer by NaviSite which specifically identifies the r in which NaviSite believes that the executive officer has not substantially performed his duties. For purposes definition, no act or failure to act on the executive officer s part shall be deemed willful unless done or omitted one by the executive officer not in good faith and without reasonable belief that his action or omission was in t interest of NaviSite.

ge of Control means the first to occur of any of the following:

acquisition by an individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the ies Exchange Act of 1934 (the **Exchange Act**)) (a **Person**) of beneficial ownership of any capital stock of te if, after such acquisition, such Person beneficially owns (within the meaning of Rule 13d-3 promulgated he Exchange Act) 50% or more of either (x) the then-outstanding shares of Common Stock of NaviSite (the **anding Company Common Stock**) or (y) the combined voting power of the then-outstanding securities of te entitled to vote generally in the election of directors (the **Outstanding Company Voting Securities**); ed, however, that for purposes of this subsection (A), any acquisition directly from NaviSite shall not ute a Change of Control; or

h time as the Continuing Directors (as defined below) do not constitute a majority of the Board (or, if ble, the Board of a successor corporation to NaviSite), where the term Continuing Director means at any date ber of the Board (x) who was a member of the Board on the date of the initial adoption of the separation ent by the Board or (y) who was nominated or elected subsequent to such date by at least a majority of the rs who were Continuing Directors at the time of such nomination or election or whose election to the Board ommended or endorsed by at least a majority of the directors who were Continuing Directors at the time of omination or election; provided, however, that there shall be excluded from this clause (y) any individual initial assumption of office occurred as a result of an actual or threatened election contest with respect to the n or removal of directors or other actual or threatened solicitation of proxies or consents, by or on behalf of a other than the Board; or

consummation of a merger, consolidation, reorganization, recapitalization or share exchange involving te or a sale or other disposition of all or substantially all of the assets of NaviSite (a **Business Combination**), immediately following such Business Combination, each of the following two conditions is satisfied: (x) all tantially all of the individuals and entities who were the beneficial owners of the Outstanding Company on Stock and Outstanding Company Voting Securities immediately prior to such Business Combination ially own, directly or indirectly, more than 50% of the then-outstanding shares of Common Stock and the ed voting power of the then-outstanding securities entitled to vote generally in the election of directors, ively, of the resulting or acquiring corporation in such Business Combination (which shall include, without on, a corporation which as a result of such transaction owns NaviSite or substantially all of NaviSite s assets irectly or through one or more subsidiaries) (such resulting or acquiring corporation is referred to herein as **cquiring Corporation**) in substantially the same proportions as their ownership of the Outstanding Company on Stock and Outstanding Company Voting Securities, respectively, immediately prior to such Business nation and (y) no Person (excluding any employee benefit plan (or related trust) maintained or sponsored by te or by the Acquiring Corporation) beneficially owns, directly or indirectly, 40% or more of the tstanding shares of Common Stock of the Acquiring Corporation, or of the combined voting power of the tstanding securities of such corporation

f Contents

to vote generally in the election of directors (except to the extent that such ownership existed prior to the ss Combination); or

liquidation or dissolution of NaviSite.

ility shall be deemed to have occurred if, as a result of incapacity due to physical or mental illness, the ve officer shall have been absent from the full time performance of his duties with NaviSite for six secutive months and, within thirty (30) days after written notice of termination by reason of disability is given xecutive officer, the executive officer shall not have returned to the full time performance of his duties.

Reason means, without the executive officer s express written consent, the occurrence after a Change of of NaviSite of any of the following circumstances unless, in the cases of paragraphs (i), (ii), (iii), (iv), (v) or ch circumstances are fully corrected prior to the date of termination specified in the notice of termination n respect thereof:

significant diminution in the executive officer s position, duties, responsibilities, power, or office (not solely a in title) as in effect immediately prior to a Change of Control (unless such changes are required and solely to the reporting structures of an Acquiring Corporation);

reduction, without the executive officer s consent, in his annual base salary as in effect on the date of the ion agreement or as the same may be increased from time to time;

failure by NaviSite to (i) continue in effect any material compensation or benefit plan in which the executive participates immediately prior to the Change of Control, unless an equitable arrangement (embodied in an g substitute or alternative plan) has been made with respect to such plan, or (ii) continue the executive officer s pation therein (or in such substitute or alternative plan) on a basis not materially less favorable, both in terms mount of benefits provided and the level of the executive officer s participation relative to other participants, ed at the time the Change of Control;

failure by NaviSite to continue to provide the executive officer with benefits substantially similar to those d by him under any of NaviSite s life insurance, medical, health and accident, or disability plans in which he rticipating at the time of the Change of Control, the taking of any action by NaviSite which would directly or tly materially reduce any of such benefits, or the failure by NaviSite to provide the executive officer with the r of paid vacation days to which he is entitled on the basis of years of service with NaviSite in accordance with te s normal vacation policy in effect at the time of the Change of Control;

requirement by NaviSite or of any person in control of NaviSite that the location at which the executive performs his principal duties for NaviSite be changed to a new location that is outside a radius of fifty les from his principal place of employment at the time of the Change of Control; or

failure of NaviSite to obtain a reasonably satisfactory agreement from any successor to assume and agree to n the separation agreement, as contemplated in the separation agreement;

order to establish Good Reason for a termination, the executive officer must provide notice to NaviSite of the ce of the condition giving rise to the Good Reason within 90 days following the initial existence of the on, and NaviSite has 30 days following receipt of such notice to remedy such condition.

f Contents

lowing table summarizes compensation paid to our non-employee directors during fiscal 2010.

DIRECTOR COMPENSATION FOR FISCAL 2010

	Fees Earned or Paid in Cash ($)	Stock Awards ($)(1)(2)	Total ($)
Dennedy(3)	78,500	31,028	109,528
s R. Evans(4)	71,000	31,028	102,028
y Ruhan(5)	51,000	31,028	82,028
chwartz(6)	83,500	31,028	114,528

he amounts shown in the Stock Awards column represent the aggregate grant date fair value of awards mputed in accordance with FASB ASC Topic 718, not the actual amounts paid to or realized by the directors ring fiscal 2010.

estricted stock awards vest in equal monthly installments over a period of twelve months from the date of ant (December 15, 2009).

s of July 31, 2010, Mr. Dennedy held 6,566 unvested shares of restricted stock and options (vested) to rchase 115,000 shares of our Common Stock.

s of July 31, 2010, Mr. Evans held 6,566 unvested shares of restricted stock and options (vested) to purchase ,000 shares of our Common Stock.

s of July 31, 2010, Mr. Ruhan held 6,566 unvested shares of restricted stock and options (vested) to purchase ,000 shares of our Common Stock.

s of July 31, 2010, Mr. Schwartz held 6,566 unvested shares of restricted stock and options (vested) to rchase 115,000 shares of our Common Stock.

gust 10, 2007, based upon the recommendation of the GNC Committee, the Board adopted the NaviSite, Inc. ed and Restated Director Compensation Plan (the **Plan**). The Plan provides that each independent director and irman of the Board shall be paid an annual fee of $36,000. In addition, the Plan provides that the chairman of C Committee and the chairman of the Audit Committee shall each receive an additional annual fee of). Each member of the GNC Committee and the Audit Committee (other than the chair of each such ttee) shall receive an additional annual fee of $7,500, and the chairman of the Board shall receive an additional fee of $15,000. All annual fees shall be payable in quarterly installments. The Plan also provides that upon lection to the Board, each independent director and the chairman of the Board shall receive an initial grant of shares of restricted Common Stock. The shares subject to the initial grant shall vest monthly over a period of ix months. Upon re-election to the Board, each independent director and the chairman of the Board shall a grant of 15,750 shares of restricted Common Stock. The members of the Audit Committee and the GNC ttee, and the committee chairs, will not receive any additional shares of restricted Common Stock as a result membership on such committees or position as a chair of such committee. The shares of restricted Common ubject to the annual grant shall vest monthly over a period of twelve months. Upon a change in control of e, the shares subject to the initial grant and the annual grant shall become fully vested.

fiscal 2010, Mr. Becker was not paid for his service on the Board. In accordance with the Plan, upon ion to the Board, each of Messrs. Ruhan (chairman), Evans, Dennedy and Schwartz received a grant of shares of restricted Common Stock on December 15, 2009. The shares of restricted stock vest monthly over a of twelve months. In addition, under the Plan, we paid: (i) Mr. Dennedy $58,500 for his service as an ndent director, chairman of the Audit Committee and as a member of the GNC Committee, (ii) Mr. Evans 0 for his service as an independent director, a member of the Audit Committee and a member of the GNC ttee, (iii) Mr. Schwartz $58,500 as an independent director, chairman of the GNC Committee and member of dit Committee and (iv) and Mr. Ruhan $51,000 as chairman of the Board. Messrs. Schwartz, Dennedy and also served on a special committee in fiscal 2010 in which they evaluated possible transactions for NaviSite. hwartz received $25,000 as chairman

f Contents

committee in fiscal 2010 and Messrs. Dennedy and Evans each received $20,000 for their service on this tee in fiscal 2010.

rom the arrangements discussed above, we do not pay any cash compensation to members of our Board for rvices as members of the Board, although directors are reimbursed for their reasonable travel expenses d in connection with attending Board and committee meetings. Directors who are also NaviSite officers or ees are eligible to participate in the Amended and Restated 2003 Stock Incentive Plan.

ember of the Board has entered into an indemnification agreement with us pursuant to which they will be ified by us, subject to certain limitations, for any liabilities incurred by them in connection with their role as rs of NaviSite.

ADDITIONAL INFORMATION

ndent Registered Public Accounting Firm Fees

lowing table presents fees for professional audit services rendered by KPMG LLP for the audit of our annual dated financial statements for fiscal 2010 and 2009, and fees billed for other services rendered by KPMG

	2010	2009
ees(1)	$ 704,800	$ 686,000
Related Fees(2)		
nd Audit-Related Fees	704,800	686,000
es(3)	150,000	78,000
er Fees(4)		
ees	$ 854,800	$ 764,000

dit fees consisted principally of fees for the audit in accordance with the Standards of the Public Company ccounting Oversight Board (United States) and quarterly reviews of the consolidated financial statements. The dit fee for both fiscal years also includes fees for the review of NaviSite s annual and quarterly reports, and nsents included within NaviSite s annual report.

aviSite did not incur any audit-related fees during fiscal 2010 or fiscal 2009.

x fees consisted principally of fees for tax compliance, tax planning and tax advice, including a change of wnership analysis and a NOL study performed in fiscal 2010.

aviSite did not incur any other fees during fiscal 2010 or fiscal 2009 for products and services provided by PMG LLP other than those disclosed above.

on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent ered Public Accounting Firm

dit Committee s policy is to pre-approve all audit and permissible non-audit services provided by the ndent registered public accounting firm. These services may include audit services, audit-related services, tax s and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as articular service or category of services and is generally subject to a specific budget. The independent ed public accounting firm and management are required to periodically report to the Audit Committee ng the extent of services provided by the independent registered public accounting firm in accordance with -approval, and the fees for the services performed to date. The Audit Committee may also pre-approve ar services on a case-by-case basis. During fiscal 2010 and fiscal 2009, all services rendered by KPMG LLP Site were pre-approved by the Audit Committee.

f Contents

Committee Financial Expert

ard has determined that James Dennedy is an audit committee financial expert (as defined in Item 407(d)(5) ulation S-K). Mr. Dennedy is independent as defined in applicable Nasdaq listing standards.

Committee Report

dit Committee of the Board has reviewed and discussed NaviSite s audited financial statements for fiscal 2010 aviSite s management. The Audit Committee has discussed with KPMG LLP, NaviSite s independent ed public accounting firm, the matters required to be discussed by the Statement on Auditing Standards The Audit Committee has received the written disclosures and the letter from KPMG LLP required by the ble requirements of the Public Company Accounting Oversight Board regarding the independent accountant s nications with the Audit Committee concerning independence, and has discussed with KPMG LLP its ndence. The Audit Committee also considered whether KPMG LLP s provision of non-audit services to e is compatible with maintaining KPMG LLP s independence. Based on the review and discussions described among other things, the Audit Committee recommended to the Board that the audited financial statements be d in NaviSite s Annual Report on Form 10-K for fiscal 2010.

COMMITTEE

Dennedy, Chairman
chwartz
s R. Evans

ormation contained in the foregoing report shall not be deemed to be soliciting material or filed or rated by reference into any of NaviSite s previous or future filings with the SEC, or subject to the liabilities of 18 of the Exchange Act, except to the extent specifically incorporated by reference into a document filed he Securities Act or the Exchange Act.

n Relationships and Related Transactions

dit Committee has the following unwritten policies and procedures for the review and approval of party transactions. A related-party transaction is a transaction that meets the minimum threshold for ure in the proxy statement under the relevant SEC rules (generally, transactions involving amounts exceeding er of $120,000 or one percent of the average of NaviSite s total assets at year end for the last two completed ears in which a related person or entity has a direct or indirect material interest). Related persons include e s executive officers, directors, 5% or more beneficial owners of our Common Stock, immediate family rs of these persons and entities in which one of these persons has a direct or indirect material interest. When a al related-party transaction is identified, management presents it to the Audit Committee to determine whether ove or ratify it.

dit Committee reviews the material facts of any related-party transaction and either approves or disapproves ring into the transaction. In the course of reviewing the related-party transaction, the Audit Committee rs whether (i) the transaction is fair and reasonable to NaviSite, (ii) under all of the circumstances the tion is in, or not inconsistent with, NaviSite s best interests, and (iii) the transaction will be on terms no less ble to NaviSite than it could have obtained in an arms -length transaction with an unrelated third party. If e approval of a related-party transaction is not feasible, then the transaction will be considered and, if the Committee determines it to be appropriate, ratified by the Audit Committee. No director may participate in the al of a transaction for which he or she is a related party.

a related-party transaction is ongoing, any amendments or changes are reviewed and the transaction is ed annually for reasonableness and fairness to NaviSite.

21

f Contents

lue Technologies (UK) Limited and Global Marine Systems

ing April 1, 2004, we entered into an outsourcing agreement with ClearBlue Technologies (UK) Limited **rBlue**) whereby we provide certain management services as well as manage the day-to-day operations as d by ClearBlue s customers contracts. We charge ClearBlue a monthly fee of £4,700, plus 20% of gross profit profit is revenue collected from ClearBlue customers, less the monthly fee), but in the event such calculation is n $0, 100% of the gross profit shall remain with ClearBlue. In addition, we provide hosting services for Marine Systems. During fiscal 2010 and fiscal 2009, we generated revenue of approximately $141,000 and 00, respectively, under these arrangements. ClearBlue and Global Marine Systems are controlled by han, the chairman of our Board.

'ang

l 2010 and fiscal 2009, we performed professional and hosting services for Vera Wang, whose chief executive and owner is the spouse of Mr. Becker, our former chief executive officer and current Board member. During 010 and fiscal 2009, revenue generated from Vera Wang was approximately $162,000 and $233,000, ively.

n III Limited and Sentrum Services Limited

ruary 4, 2008, one of our subsidiaries, NaviSite Europe Limited, entered into and we guaranteed a Lease nent (the **Lease**) for approximately 10,000 square feet of data-center space located in Watford, Hertfordshire, d, with Sentrum III Limited. The Lease has a 7-year term. NaviSite Europe Limited and NaviSite are also to a Services Agreement with Sentrum Services Limited for the provision of services within the data center. fiscal 2010 and fiscal 2009, we paid $2.5 million and $2.4 million, respectively, under these arrangements. han, the chairman of our Board has a financial interest in each of Sentrum III Limited and Sentrum Services d.

n IV Limited

ember 2007 NaviSite Europe Limited entered into and we guaranteed a lease-option agreement for nter space in Woking, Surrey, England with Sentrum IV Limited. As part of this lease-option agreement we fully refundable deposit of $5 million in order to secure the right to lease the space upon the completion of ding construction. In July 2008 the final lease agreement was completed for approximately 11,000 square feet -center space. Subsequent to July 31, 2008, the deposit was returned to us. Mr. Ruhan, the chairman of our has a financial interest in Sentrum IV Limited. In September 2009 the parties terminated this arrangement.

dit Committee approved or ratified each of the transactions mentioned above.

n 16(a) Beneficial Ownership Reporting Compliance

16(a) of the Exchange Act requires our directors and executive officers and persons who own more than 10% gistered class of our equity securities (collectively, **Reporting Persons**) to file reports of beneficial ownership nges in beneficial ownership with the SEC. Based solely upon review of copies of such reports, or other representations from Reporting Persons, we believe that, during fiscal 2010, all Reporting Persons complied applicable requirements of Section 16(a) of the Exchange Act. There are no known failures to file a required , Form 4 or Form 5.

l Report on Form 10-K

of our Annual Report on Form 10-K (with the consolidated financial statements and all exhibits) for fiscal led with the SEC may be accessed from the SEC s website (www.sec.gov) or may be obtained without charge ritten request to NaviSite, Inc., 400 Minuteman Road, Andover, Massachusetts 01810, Attention: Investor ns.

22

f Contents

holding of Annual Meeting Materials

anks, brokers and other nominee record holders may participate in the practice of householding proxy ents, annual reports and notices of Internet availability of proxy materials. This means that only one copy of xy Statement, 2010 Annual Report or Notice of Internet Availability of Proxy Materials may have been sent iple stockholders in your household. We will promptly deliver a separate copy of the Notice of Internet bility of Proxy Materials and, if applicable, a separate copy of the Proxy Statement and 2010 Annual Report to neficial owner at a shared address to which a single copy of any of those documents was delivered if you write us at the following address or telephone number: Investor Relations Department, NaviSite, Inc., 400 man Road, Andover, Massachusetts 01810, telephone: (978) 682-8300. If you want to receive separate copies Proxy Statement, 2010 Annual Report or Notice of Internet Availability of Proxy Materials in the future, or if receiving multiple copies and would like to receive only one copy for your household, you should contact nk, broker, or other nominee record holder, or you may contact NaviSite at the above address and telephone r.

Matters

ard does not know of any other matters which may come before the Annual Meeting. However, if any other do properly come before the Annual Meeting or any adjournments or postponements thereof, the Board that the persons named in the proxies will vote upon such matters in accordance with their best judgment.

older Proposals

oposal that a stockholder of NaviSite wishes to be considered for inclusion in our proxy statement, Notice of t Availability of Proxy Materials and proxy card for the Company s 2011 Annual Meeting of Stockholders (the **Annual Meeting**) must be submitted to the Assistant Secretary of NaviSite at our offices, 400 Minuteman Andover, Massachusetts 01810, no later than July 4, 2011. In addition, such proposals must comply with the ments of Rule 14a-8 under the Exchange Act and our By-Laws, as applicable.

ckholder of NaviSite wishes to present a proposal or nominate a director before the 2011 Annual Meeting, but t wish to have the proposal considered for inclusion in the proxy statement, Notice of Internet Availability of Materials and proxy card, such stockholder must also give written notice to the Assistant Secretary of NaviSite ddress noted above. The Assistant Secretary must receive such notice no earlier than September 4, 2011 and than September 19, 2011 (unless the Company s 2011 Annual Meeting is held before November 14, 2011 or nuary 13, 2012, in which case different deadlines are established by our By-Laws) and the stockholder must with the provisions of our By-Laws.

er of the Board of Directors,

s B. Rosedale
nt Secretary

ber 1, 2010

23

f Contents

MMMMMMMMMM MMMMMMMMMMMMMMM C123456789 IMPORTANT ANNUAL ING INFORMATION 000004 000000000.000000 ext 000000000.000000 ext RSEMENT_LINE SACKPACK 000000000.000000 ext 000000000.000000 ext MMMMMMM 000000000.000000 ext 000000000.000000 ext MR A SAMPLE Electronic Voting tions DESIGNATION (IF ANY) You can vote by Internet or telephone! ADD 1 Available 24 . day, 7 days a week! ADD 2 ADD 3 Instead of mailing your proxy, you may choose one of the ting methods outlined below to vote your proxy. ADD 4 ADD 5 VALIDATION DETAILS ARE TED BELOW IN THE TITLE BAR. ADD 6 Proxies submitted by the Internet or telephone must ived by 1:00 a.m., Eastern Time, on December 14, 2010. Vote by Internet Log on to the Internet to www.investorvote.com/NAVI Follow the steps outlined on the secured website. Vote by one Call toll free 1-800-652-VOTE (8683) within the USA, US territories & Canada any time on . tone telephone. There is NO CHARGE to you for the call. Using a black ink pen, mark your vith an X as shown in X Follow the instructions provided by the recorded message. this example. do not write outside the designated areas. Annual Meeting Proxy Card 1234 5678 9012 345 3 IF HAVE NOT VOTED VIA THE INTERNET OR TELEPHONE, FOLD ALONG THE ORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED LOPE. 3 A Proposals A vote FOR the director nominees and FOR the ratification of the tment of KPMG LLP as independent registered public accounting firm is recommended by the of Directors. 1. Election of Directors: For Withhold For Withhold For Withhold + 01 Andrew 02 Arthur P. Becker 03 James Dennedy 04 Larry Schwartz 05 - Thomas R. Evans For Against n 2. Ratification of the appointment of KPMG LLP as independent registered public accounting r the fiscal year ending July 31, 2011. IN THEIR DISCRETION, THE PROXIES ARE ORIZED TO VOTE UPON SUCH OTHER BUSINESS AS MAY PROPERLY COME BEFORE NNUAL MEETING AND ANY ADJOURNMENT THEREOF. B Non-Voting Items Change of s Please print new address below. Comments Please print your comments below. C Authorized ures This section must be completed for your vote to be counted. Date and Sign Below Please is proxy exactly as your name appears hereon. Joint owners should each sign personally. Trustees her fiduciaries should indicate the capacity in which they sign. If a corporation or partnership, this re should be that of an authorized officer who should state his or her title. Date (mm/dd/yyyy) print date below. Signature 1 Please keep signature within the box. Signature 2 Please keep re within the box. C 1234567890 J N T MR A SAMPLE (THIS AREA IS SET UP TO MMODATE 140 CHARACTERS) MR A SAMPLE AND MR A SAMPLE AND MR A LE AND MR A SAMPLE AND MR A SAMPLE AND MMMMMMM1 U P X 1 0 3 2 0 8 1 MR IPLE AND MR A SAMPLE AND MR A SAMPLE AND + 018Q6B

---

f Contents

tockholder: Please take note of the important information enclosed with this proxy. There are a r of issues related to the operation of NaviSite that require your immediate attention. Your vote and you are strongly encouraged to exercise your right to vote your shares. Please mark the on the proxy card to indicate how your shares will be voted. Then sign the card, detach it and your proxy in the enclosed postage-paid envelope. Thank you in advance for your prompt eration of these matters. 3 IF YOU HAVE NOT VOTED VIA THE INTERNET OR PHONE, FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM ION IN THE ENCLOSED ENVELOPE. 3 Proxy NAVISITE, INC. 400 MINUTEMAN ROAD VER, MA 01810 SOLICITED BY THE BOARD OF DIRECTORS FOR THE ANNUAL ING OF STOCKHOLDERS The undersigned, having received notice of the Annual Meeting of olders and the Board of Directors proxy statement therefor, and revoking all prior proxies, hereby t(s) R. Brooks Borcherding and James W. Pluntze, and each of them singly, with the power to t his substitute, and hereby authorizes each of them to represent and to vote, as designated on the side, all shares of common stock or preferred stock, as applicable, of NaviSite, Inc. (NaviSite) record by the undersigned on October 18, 2010 at the Annual Meeting of Stockholders to be held ember 14, 2010 and any adjournments thereof. None of the following proposals are conditioned e approval of any other proposal. THIS PROXY WHEN PROPERLY EXECUTED WILL BE D AS DIRECTED. IF NO DIRECTION IS GIVEN WITH RESPECT TO A PARTICULAR OSAL, THIS PROXY WILL BE VOTED FOR SUCH PROPOSAL. PLEASE MARK, DATE, AND RETURN THIS PROXY CARD PROMPTLY, USING THE ENCLOSED ENVELOPE. OSTAGE IS REQUIRED IF MAILED IN THE UNITED STATES.