ELECTRO SENSORS INC
Form 10-Q
November 12, 2010

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

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

For the quarterly period ended September 30, 2010

OR

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

For the transition period from _____ to _____

Commission File Number 0-9587

ELECTRO-SENSORS, INC.

(Exact name of registrant as specified in its charter)

Minnesota	**41-0943459**

(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6111 Blue Circle Drive
Minnetonka, Minnesota 55343-9108

(Address of principal executive offices)

(952) 930-0100

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

The number of shares outstanding of the registrant s common stock, $0.10 par value, on November 11, 2010 was 3,381,999.

ELECTRO-SENSORS, INC.

Form 10-Q

For the Period Ended September 30, 2010

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1. Financial Statements:

Condensed Consolidated Balance Sheet As of September 30, 2010 and December 31, 2009	3
Condensed Consolidated Statements of Operations For the Three and Nine Month Periods Ended September 30, 2010 and September 30, 2009	4
Condensed Consolidated Statements of Cash Flows For the Nine Month Periods Ended September 30, 2010 and September 30, 2009	5
Notes to Condensed Consolidated Financial Statements	6
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	12
Item 3. Quantitative and Qualitative Disclosures About Market Risk	15
Item 4. Controls and Procedures	16

PART II OTHER INFORMATION

Item 1. Legal Proceedings	16
Item 1A. Risk Factors	16
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	16
Item 3. Defaults Upon Senior Securities	16
Item 4. [Removed and Reserved]	16
Item 5. Other Information	16
Item 6. Exhibits	16
SIGNATURES	17
EXHIBITS	18

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ELECTRO-SENSORS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

(in thousands except share and per share amounts)

	September 30, 2010 (unaudited)	December 31, 2009
ASSETS		
Current assets		
Cash and cash equivalents	**$ 686**	$ 746
Treasury bills.	**5,198**	4,980
Available for sale securities	**2,857**	2,311
Trade receivables, less allowance for doubtful accounts of $11	**678**	777
Inventories	**1,075**	908
Other current assets	**87**	84
Total current assets	**10,581**	9,806
Property and equipment, net	**1,197**	1,228
Total assets	**$ 11,778**	$ 11,034
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	**$ 157**	$ 79
Accrued expenses	**282**	172
Deferred revenue	**73**	76
Accrued income tax	**87**	15

Deferred income tax		**1,069**		877
Total current liabilities		**1,668**		1,219
Commitments and contingencies				
Stockholders equity				
Common stock par value $0.10 per share; authorized 10,000,000 shares; issued and outstanding: 3,381,999 and 3,376,794 shares, respectively		**338**		338
Additional paid-in capital		**1,541**		1,529
Retained earnings		**6,523**		6,578
Accumulated other comprehensive income (unrealized gain on available for sale securities, net of income tax)		**1,708**		1,370
Total stockholders equity		**10,110**		9,815
Total liabilities and stockholders equity	**$**	**11,778**	$	11,034

See accompanying notes to condensed consolidated financial statements

Table of Contents

ELECTRO-SENSORS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands except share and per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Net sales	**$ 1,561**	$ 1,711	**$ 4,818**	$ 4,252
Cost of goods sold	**619**	702	**1,917**	1,745
Gross profit	**942**	1,009	**2,901**	2,507
Operating expenses:				
Selling and marketing	**292**	343	**990**	994
General and administrative	**243**	265	**831**	856
Research and development	**188**	144	**495**	472
Total operating expenses	**723**	752	**2,316**	2,322
Operating income	**219**	257	**585**	185
Non-operating income (expense):				
Gain on disposal of investment securities	**0**	5	**0**	5
Interest income	**0**	3	**2**	10
Loss on disposal of fixed assets	**0**	(1)	**0**	(1)
Other income	**2**	2	**6**	7
Total non-operating income	**2**	9	**8**	21
Income before income taxes	**221**	266	**593**	206
Income taxes	**88**	106	**243**	82
Net income	**$ 133**	$ 160	**$ 350**	$ 124

Other comprehensive income:						
Change in unrealized value of investments, net of income tax	**$ 162**	$ 400	**$ 338**	$ 824		
Total comprehensive income	**$ 295**	$ 560	**$ 688**	$ 948		
Net Income per Share Data:						
Basic						
Net income per share	**$ 0.04**	$ 0.05	**$ 0.10**	$ 0.04		
Weighted average shares	**3,381,888**	3,370,997	**3,381,837**	3,369,279		
Diluted						
Net income per share	**$ 0.04**	$ 0.05	**$ 0.10**	$ 0.04		
Weighted average shares	**3,405,484**	3,401,549	**3,405,433**	3,399,982		
Dividends paid per share	**$ .04**	$ .04	**$ .12**	$ .12		

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents

ELECTRO-SENSORS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2010	**2009**
Cash flows from operating activities		
Net income	**$ 350**	$ 124
Adjustments to reconcile net income to net cash from (used in) operating activities:		
Depreciation	**72**	85
Provision for losses on trade receivables	**0**	3
Deferred income taxes	**(16)**	0
Interest accrued on investments	**(2)**	(10)
Realized (gain) loss on disposal of available for sale securities	**0**	(5)
Loss on disposal of fixed assets	**0**	1
(Increase)/decrease in:		
Trade receivables	**99**	(109)
Inventories	**(167)**	229
Other current assets	**(3)**	(5)
Income taxes receivable	**0**	98
Accounts payable	**78**	34
Accrued expenses	**110**	74
Deferred revenue	**(3)**	(11)
Accrued income taxes	**72**	0
Net cash from operating activities	**590**	508
Cash flows from (used in) investing activities		
Proceeds from sale of available for sale securities	**0**	5
Purchase of treasury bills	**(10,246)**	(9,949)
Proceeds from the sale of treasury bills	**10,030**	4,980
Purchase of property and equipment	**(41)**	(2)

Net cash used in investing activities		**(257)**		(4,966)
Cash flows from (used in) financing activities				
Proceeds from issuance of stock		**12**		10
Dividends paid		**(405)**		(404)
Net cash used in financing activities		**(393)**		(394)
Net decrease in cash and cash equivalents		**(60)**		(4,852)
Cash and cash equivalents, beginning		**746**		5,529
Cash and cash equivalents, ending		**686**	$	677
Supplemental schedule of non-cash investing and financing activities				
Net change in unrealized gain on available for sale securities	**$**	**338**	$	824
Cash paid for income taxes	**$**	**187**	$	0

See accompanying notes to unaudited condensed consolidated financial statements

Table of Contents

ELECTRO-SENSORS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions and regulations of the Securities and Exchange Commission to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

This report should be read together with the Company s annual report on Form 10-K for the year ended December 31, 2009, including the audited financial statements and footnotes therein.

It is the opinion of management that the unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring accruals, necessary to fairly state the financial position and results of operations for the three and nine months ended September 30, 2010. The results of interim periods may not be indicative of results to be expected for the year.

Nature of Business

The accompanying condensed consolidated financial statements include the accounts of Electro-Sensors, Inc. and its wholly-owned subsidiaries, ESI Investment Company and Senstar Corporation. Senstar has no operations. Intercompany accounts, transactions and earnings have been eliminated in consolidation. The consolidated entity is referred to as the Company .

Electro-Sensors, Inc. operates two distinct businesses. The first is the Production Monitoring Division, which manufactures and markets a complete line of speed monitoring and motor control systems for industrial machinery. The division utilizes leading-edge technology to continuously improve its products and make them easier to use. The division s goal is to manufacture the industry-preferred product for every market served. These products are sold through an internal sales staff, manufacturer s representatives, and distributors to a wide variety of manufacturers, original equipment manufacturers and processors to monitor process machinery operations. The division markets its products to a number of different industries located throughout the United States, Asia, Central America, Canada, and Europe.

The second business is the AutoData Systems Division. The division designs and markets desktop software based systems that read hand printed characters, checkmarks and bar code information from scanned or faxed forms, in addition to collecting and reporting data from web forms. The division s products are designed to provide capabilities to automate data collection and are sold by internal sales staff to end users, resellers and developers in the United States, Canada, Europe and Asia.

In addition, through its subsidiary ESI Investment Company, the Company periodically makes strategic investments in other businesses and companies, primarily when the Company believes that such investments will facilitate development of technology complementary to the Company s products. Although ESI, through ESI Investment Company, invests in other businesses or companies, ESI does not intend to become an investment company and intends to remain primarily an operating company. The Company s primary investments are 343,267 shares of Rudolph Technologies, Inc. (Rudolph) and 551,759 shares of PPT Vision Inc (PPT). The Rudolph investment is accounted for using the available-for-sale method. The PPT investment is accounted for under the equity method of accounting. See Note 5 for additional information regarding the Company s investments. The Company s investments in securities are subject to normal market risks.

Revenue recognition of production monitoring equipment

The Company recognizes revenue from the sale of its production monitoring equipment when persuasive evidence of an arrangement exists, the product has been delivered, the fee is fixed and determinable and collection of the resulting receivable is reasonably assured. The Company may offer discounts to its distributors or quantity discounts that are recorded at the time of sale. The Company recognizes revenue on products sold to customers and distributors upon shipment because the contracts do not include post-shipment obligations. In addition to exchanges and warranties, customers have refund rights. Our standard products are used in a wide variety of industries, returns are minimal and insignificant to the consolidated financial statements and are recognized when the returned product is received by the Company. In some situations, the Company receives advance payments from its customers. Revenue associated with these advance payments is deferred until the product is shipped or services performed.

Table of Contents

Software revenue recognition

The Company recognizes revenue upon shipment of its automated data collection software. The product is sold to the end user and risk of loss is transferred, and the Company has no continuing obligations, once its products are delivered to the shipper. To recognize revenue, it must also be probable that the Company will collect the accounts receivable from its customers. AutoData customers pay an annual maintenance fee for software support, which is recorded as deferred revenue on the balance sheet and is recognized in income, on a monthly basis, over the life of the contract. The Company recognizes hardware shipped with software when persuasive evidence of an arrangement exists, the product has been delivered, the fee is fixed and determinable, and collection of the resulting receivable is reasonably assured.

Available for Sale Securities

ESI Investment Company s investments consist of equity securities, primarily common stocks, government debt securities and money market funds. The estimated fair value of publicly traded equity is based on quoted market prices, and therefore subject to the inherent risk of market fluctuations. Management determines the appropriate classification of securities at the date individual investments are acquired, and evaluates the appropriateness of such classification at each balance sheet date.

Since the Company generally does not make investments in anticipation of short-term fluctuations in market prices, investments in equity securities are classified as available-for-sale (unless accounted for on the equity method of accounting). Available-for-sale securities with readily determinable values are stated at fair value, and unrealized holding gains and losses, net of the related deferred tax effect, are reported as separate component of stockholders equity.

Realized gains and losses on securities, including losses from declines in value of specific securities determined by management to be other-than-temporary (unless accounted for on the equity method of accounting), are included in income in the period realized.

Fair Value Measurements

The Company s policies incorporate the guidance for accounting for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. The Company s policies also incorporate the guidance for fair value measurement related to nonfinancial items that are recognized and disclosed at fair value in the consolidated financial statements on a nonrecurring basis. The guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The carrying value of cash and equivalents, treasury bills, investments, trade receivables, accounts payable, and other working capital items approximate fair value at September 30, 2010 and December 31, 2009 due to the short maturity nature of these instruments.

Income taxes

Deferred income taxes are provided on an asset and liability approach to financial accounting and reporting for income taxes. Deferred income tax assets and liabilities are computed for those differences that have future tax consequences using the currently enacted tax laws and rates that apply to the periods in which they are expected to affect taxable income. Income tax expense is the current tax payable or refundable for the period plus or minus the net change in the deferred tax assets and liabilities, excluding the portion of the deferred liability allocated to other comprehensive income. Deferred taxes are reduced by a valuation allowance to the extent that realization of the related deferred tax asset is not assured.

Table of Contents

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates, including the underlying assumptions, consist of economic lives of property and equipment, realizability of accounts receivable, valuation of deferred tax liabilities, valuation of inventory, and valuation of investments. It is at least reasonably possible that these estimates may change in the near term.

Note 2. Stock-Based Compensation

The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes-Merton (BSM) model. The Company uses historical data among other factors to estimate the expected price volatility, the expected option life and the expected forfeiture rate. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. At September 30, 2010, the Company had one stock-based employee compensation plan. During the nine months ended September 30, 2010, there were no stock options exercised. There were no option grants in the nine months ended September 30, 2010 and 2009.

Note 3. Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of common shares outstanding and common stock equivalents outstanding during the period.

Note 4. Treasury Bills

On January 14, 2010, the Company had $4,980,000 in Treasury Bills mature. With the proceeds, in February 2010, the Company purchased $5,048,000 in Treasury Bills which matured on July 15, 2010. With the proceeds of $5,050,000, the Company purchased, in July 2010, $4,300,000 in Treasury Bills which matured in October 2010. In August 2010, the Company purchased an additional $898,000 in Treasury Bills with a maturity date in July 2011. It is the intention of management to hold the Treasury Bills until maturity.

Table of Contents

Note 5. Investments

The cost and estimated fair value of the investments (other than an investment accounted for under the equity method of accounting) are as follows:

	Cost	Gross unrealized gain	Gross unrealized loss	Fair value
December 31, 2009				
Treasury Bills	$ 4,980,000	$ 0	$ 0	$ 4,980,000
Money Market Funds	385,000	0	0	385,000
Equity Securities	101,000	2,264,000	(54,000)	2,311,000
	5,466,000	2,264,000	(54,000)	7,676,000
Less Cash Equivalents	385,000	0	0	385,000
Total Investments, December 31, 2009	$ 5,081,000	$ 2,264,000	$ (54,000)	$ 7,291,000
September 30, 2010				
Treasury Bills	$ 5,198,000	$ 0	$ 0	$ 5,198,000
Money Market Funds	169,000	0	0	169,000
Equity Securities	101,000	2,810,000	(54,000)	2,857,000
	5,468,000	2,810,000	(54,000)	8,224,000
Less Cash Equivalents	169,000	0	0	169,000
Total Investments, September 30, 2010	$ 5,299,000	$ 2,810,000	$ (54,000)	$ 8,055,000

At September 30, 2010, the Company s significant investment in equity securities is 343,267 shares of Rudolph Technologies, Inc. (Rudolph), accounted for under the available-for-sale method. As of September 30, 2010 and December 31, 2009, the aggregate value of the Company s Rudolph shares as reported on the Nasdaq Stock Exchange was approximately $2,808,000 and $2,307,000, respectively, with an approximate cost of $45,000.

Investment Reported on Equity Method

At September 30, 2010 and December 31, 2009, the Company owned 551,759 shares of PPT Vision, Inc. (PPT), which is 1.4% of PPT s outstanding common stock. The fair value of its holdings based on the quoted market price at September 30, 2010 and December 31, 2009 was approximately $88,000 and $39,000 with an approximate cost of $2,434,000.

The Company owns approximately 1.4% of PPT s outstanding stock and the Company s Secretary owns a controlling interest in PPT, therefore, it has been determined that the Company has significant influence over the operations of PPT, and as a result its ownership interest should be reported using the equity method of accounting for investments.

Under the equity method of accounting, the Company s proportionate share of PPT s net loss would ordinarily be directly reflected on the Company s income statement, along with a corresponding reduction in the PPT investment account on the Company s balance sheet. However, where net losses exceed the value of the initial investment, these losses are no longer recognized in the financial statements, but rather are suspended and applied against the investor s proportionate share in any future net earnings for the investee. Accordingly, since the Company s proportionate share of PPT s previous net losses have already reduced the PPT investment account on its balance sheet to $0, the Company s proportionate share of PPT s net loss through September 30, 2010 has not been recognized on its current financial statements. At September 30, 2010 and December 31, 2009, the Company had approximately $1,520,000 and $1,517,000, respectively, in suspended losses from its investment in PPT that will be used to offset future recognition of equity method earnings from the investment, if any.

Table of Contents

Note 6. Fair Value Measurements

The following table provides information on those assets measured at fair value on a recurring basis.

	Carrying amount in condensed consolidated Balance Sheet December 31, 2009	Fair Value December 31, 2009	Fair Value Measurement Using		
			Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents:					
Money Market Funds	$ 385,000	$ 385,000	$ 385,000	$	$
Treasury Bills	$ 4,980,000	$ 4,980,000	$ 4,980,000	$	$
Available-for-sale:					
Equity Securities	$ 2,311,000	$ 2,311,000	$ 2,311,000	$	$

	Carrying amount in condensed consolidated Balance Sheet September 30, 2010	Fair Value September 30, 2010	Fair Value Measurement Using		
			Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents:					
Money Market Funds	$ 169,000	$ 169,000	$ 169,000	$	$
Treasury Bills	$ 5,198,000	$ 5,198,000	$ 5,198,000	$	$
Available-for-sale:					
Equity Securities	$ 2,857,000	$ 2,857,000	$ 2,857,000	$	$

The fair value of the money market funds, treasury bills, and equity securities are based on quoted market prices in an active market. Closing stock prices are readily available from active markets and are used as being representative of fair value. The Company classifies these securities as level 1.

Note 8. Inventories

Inventories used in the determination of cost of goods sold are as follows:

	September 30, 2010	**December 31, 2009**
Raw Materials	**$ 684,000**	$ 624,000
Work In Process	**207,000**	134,000
Finished Goods	**184,000**	150,000
Total Inventories	**$ 1,075,000**	$ 908,000

Table of Contents

Note 9. Segment Information

The Company has three reportable operating segments based on the nature of its product lines: Production Monitoring, AutoData Systems, and Investments. The Production Monitoring Division manufactures and markets a complete line of production monitoring equipment, in particular speed monitoring and motor control systems for industrial machinery. The AutoData Systems Division designs and markets desktop software-based systems that read hand printed characters, checkmarks, and bar code information from scanned or faxed forms, in addition to collecting and reporting data from web forms. Sales of this system include software and can include hardware. ESI Investment Company holds investments in marketable and non-marketable securities.

The accounting policies of the segments are the same as those described in Note 1 of the Company s annual report on Form 10-K for the year ended December 31, 2009. In evaluating segment performance, management focuses on sales and income before taxes. The Company has no inter-segment sales.

The following is financial information relating to the continuing operating segments (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
External sales				
Production monitoring (products)	**$ 1,469**	$ 1,604	**$ 4,519**	$ 3,960
Character recognition (software and related hardware)	**92**	107	**299**	292
Investments	**0**	0	**0**	0
Total	**$ 1,561**	$ 1,711	**$ 4,818**	$ 4,252
Net Income/(Loss) before taxes				
Production monitoring	**$ 231**	$ 263	**$ 606**	$ 239
Character recognition	**(11)**	(4)	**(16)**	(46)
Investments	**1**	7	**3**	13
Total	**$ 221**	$ 266	**$ 593**	$ 206

11

Table of Contents

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

CRITICAL ACCOUNTING ESTIMATES

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make decisions based upon estimates, assumptions, and factors it considers relevant to the circumstances. Such decisions include the selection of applicable accounting principles and the use of judgment in their application, the results of which impact reported amounts and disclosures. Changes in economic conditions or other business circumstances may affect the outcomes of management s estimates and assumptions. An in-depth description of our accounting estimates can be found in the interim financial statements included in this report and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009. No new estimates exist other than those discussed in our Annual Report.

RESULTS OF OPERATIONS

Net Sales

Net sales for the three-month period ended September 30, 2010 decreased $150,000, or 8.8%, when compared to net sales for the same period in 2009. Net sales for the nine-month period ended September 30, 2010 increased $566,000, or 13.3%, when compared to net sales for the same period in 2009.

For the three months ended September 30, 2010 compared to the same period in 2009, the Production Monitoring Division had a decrease in net sales of $135,000, or 8.4%, and the AutoData Systems Division had a decrease in net sales of $15,000, or 14.0%.

For the nine months ended September 30, 2010 compared to the same period in 2009, the Production Monitoring Division had an increase in net sales of $559,000, or 14.1%, and the AutoData Systems Division had an increase in net sales of $7,000, or 2.4%.

Sales for the nine-months ended September 30, 2010 have increased 14.1%, reflecting increases across most industries that we serve and our various product lines. The decrease in the Production Monitoring Division for the third quarter of 2010 was due to a reduction in the number of sales of complete Electro-Sentry systems that included the controller and inputs and outputs preassembled in an enclosure when compared to the same period last year. More of our customers integrated our hazard monitoring sensors with existing equipment controller systems or purchased through a system integrator that supplied the equipment controller and related inputs and outputs. Throughout the remainder of 2010, we expect to continue to expand the number of manufacturer s representatives and exclusive distributors. We have recently added a new manufacturer s representative in western Canada. Our corporate web site provides significant information and product application knowledge to existing and prospective customers and also direct knowledge to our sales partners, which we believe has a positive impact on our sales.

The AutoData Systems Division decrease in net sales for the third quarter of 2010 was due mainly to delays in implementation of federal governmental requirements for healthcare regarding electronic medical record (EMR) software. This delay has created uncertainty in the healthcare marketplace and has delayed all software purchase decisions. Since over 70% of the division s customers are in healthcare, this delay has had an impact on sales. We are cautiously optimistic that the fourth quarter of 2010 will see a decrease in the uncertainty in the healthcare marketplace as governmental entities begin to implement the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, which may result in an increase in sales.

Cost of Goods Sold

Our cost of goods sold decreased $83,000, or 11.8%, for the three months ended September 30, 2010 compared to the same period in 2009. For the nine-month period ended September 30, 2010, the cost of goods sold increased $172,000, or 9.9%, compared to the same period in 2009. These changes were primarily a result of the change in sales.

Gross Profit

Gross margin for the three-month period ended September 30, 2010 was 60.3% versus 59.0% for the same period in 2009. For the nine-month periods ended September 30, 2010 and 2009, gross margins were 60.2% and 59.0%, respectively. The increase in gross margin was due to a decrease in relative sales volume of lower margin, higher-priced items, such as the Electro-Sentry systems, within the Production Monitoring Division.

Table of Contents

Operating Expenses

Total operating expenses decreased $29,000, or 3.9%, for the three months ended September 30, 2010 when compared to the same period of 2009. Of this decrease, the Production Monitoring Division had a decrease of $17,000, or 2.6%, and the AutoData Systems Division had a decrease of $12,000, or 11.9%.

For the nine months ended September 30, 2010 when compared to the same period of 2009, operating expenses decreased $6,000, or .3%. Of this decrease, the AutoData Systems Division had a decrease of $27,000, or 8.8%, offset by an increase in the Production Monitoring Division of $21,000, or 1.0%.

Selling and marketing costs decreased $51,000, or 14.9%, for the three months ended September 30, 2010 when compared to the same period in 2009. For the nine months ended September 30, 2010, selling and marketing costs decreased $4,000, or .4%, when compared to the same period in 2009. Of the decrease for the three months ended September 30, 2010, the AutoData Systems Division had a decrease of $2,000, or 5.7%, and the Production Monitoring Division had a decrease of $49,000, or 15.9%. Of the decrease for the nine months ended September 30, 2010, the Production Monitoring Division had a decrease of $2,000, or .2%, and the AutoData Systems Division had a decrease of $2,000, or 2.0%. For the three months ended September 30, 2010, the decrease in the AutoData Systems Division expenses was due to a decrease in sales commissions and wages. The decrease in the Production Monitoring Division was due to a decrease in wages and benefits (due to changes in our compensation package and an open position) contract personnel, and advertising and marketing expenses, offset by an increase in outside sales representative commissions due to increased sales and the addition of a Canadian sales representative. For the nine months ended September 30, 2010, the decrease in the Production Monitoring Division was due to wages and benefits (due to changes in our compensation package and an open position) contract personnel, advertising and marketing, and website development expenses (due to translation of our corporate website into Chinese and Spanish during 2009), offset by an increase in outside sales representative commissions (due to increased sales) and travel expenses. Marketing efforts are continuing to be directed to our core industries and to industries that are receiving funds in connection with the federal economic stimulus package. The decrease in selling and marketing costs in the AutoData Systems Division was due to a decrease in advertising expenses, offset by an increase in wages.

General and administrative costs decreased $22,000, or 8.3%, for the three months ended September 30, 2010 compared to the same period in 2009. For the nine months ended September 30, 2010, general and administrative costs decreased $25,000, or 2.9%, when compared to the same period in 2009. Of the decrease for the three months ended September 30, 2010, the Production Monitoring Division contributed a decrease of $15,000, or 6.0%, and the AutoData Systems Division had a decrease of $7,000, or 41.2%. The decrease for the nine months ended September 30, 2010 was due to a decrease in costs of $13,000, or 1.6%, from the Production Monitoring Division, and the AutoData Systems Division decrease of $12,000, or 20.7%. For the three months ended September 30, 2010, the

decrease in general and administrative expenses from the Production Monitoring Division was due to decreases in doubtful account writeoffs and legal and professional fees. The decrease in the AutoData Systems Division was due to a decrease in computer maintenance and legal and professional fees. For the nine months ended September 30, 2010, the decrease in general and administrative expenses from the Production Monitoring Division was due to decreases in depreciation expense, doubtful account writeoffs, and legal and professional fees. The decrease in the AutoData Systems Division was due to a decrease in computer maintenance and legal and professional fees.

Research and development costs for the three months ended September 30, 2010 increased $44,000, or 30.6%, compared to the same period in 2009. For the nine months ended September 30, 2010, research and development costs increased $23,000, or 4.9%, when compared to the same period in 2009. For the three months ended September 30, 2010, the Production Monitoring Division had an increase of $47,000, or 49.5%, offset by a decrease in the AutoData Systems Division of $3,000, or 6.1%. Of the increase for the nine months ended September 30, 2010, the Production Monitoring Division contributed an increase of $36,000, or 11.1%, offset by a decrease in the AutoData System Division of $13,000, or 8.8%. For the three months ended September 30, 2010, the increase in the Production Monitoring Division was due to contract engineering, salaries and wages, lab material, and prototypes. The increased lab material, prototypes, and contract engineering expenses were due to expenses associated with new products and changes to existing products. The decrease in the AutoData Systems Division was due to a decrease in employee benefits and depreciation expense. For the nine months ended September 30, 2010, the increase in the Production Monitoring Division was due to increases in prototypes, salaries and wages, contract engineering, and travel for service calls, offset by a decrease in lab testing for product certification and legal and professional fees for trademark and patent work. The increased lab material, prototypes, and contract engineering expenses were due to printed circuit board layouts associated with new products and changes to existing products. The decrease in the AutoData Systems Division was due to a decrease in wages and benefits, and depreciation expense.

Table of Contents

Non-Operating Income

Non-operating income decreased by $7,000, or 77.7%, for the three-month period ended September 30, 2010 compared to the same period for 2009. For the nine months ended September 30, 2010, non-operating income decreased $13,000, or 61.9%, when compared to the same period in 2009. The decrease for the three-month and nine-month period ended September 30, 2010 was due to a decrease in interest income.

Interest income decreased $3,000, or 100.0%, when comparing the three months ended September 30, 2010 to the same period in 2009. For the nine months ended September 30, 2010, interest income decreased $8,000, or 80.0%, when compared to the same period in 2009. These decreases were due to the decreased interest rate on Treasury Bills, which was .081% at September 30, 2010, compared to .152% at September 30, 2009.

Income Before Income Taxes

Income before income taxes decreased $45,000, or 16.9%, to an income before tax of $221,000 for the three-month period ended September 30, 2010 compared to the same period in 2009. For the nine-month period ended September 30, 2010 income before income tax increased $387,000, or 187.9%, to an income before tax of $593,000, when compared to the same period in 2009.

The Production Monitoring Division had income before income taxes of $231,000 for the three months ended September 30, 2010 compared to $263,000 for the same period in 2009, a decrease of $32,000, or 12.2%. For the nine months ended September 30, 2010, the Production Monitoring Division had income before income taxes of $606,000 compared to $239,000 for the same period in 2009, an increase of $367,000, or 153.6%. The decrease in income before income taxes for the three months ended September 30, 2010 was mainly due to a decrease in net sales, due to the decrease in Electro-Sentry systems sold. The increase in net income before income taxes for the nine months ended September 30, 2010 was primarily due to an increase in sales and gross margin.

The AutoData Systems Division had a loss before income taxes of $11,000 for the three months ended September 30, 2010 compared to a loss before income taxes of $4,000 for the same period in 2009, a decrease of $7,000, or 175.0%. This increase in loss before income taxes was due primarily to a decrease in sales. For the nine months ended September 30, 2010, the AutoData Systems Division had a loss before income taxes of $16,000 compared to a loss before income taxes of $46,000 for the same period in 2009, a decrease in the loss of $30,000, or 65.2%. This

decrease in the loss before income taxes was due primarily to a decrease in the percentage of operating expenses to net sales (from 104.8% of net sales in 2009 to 93.3% of net sales in 2010).

ESI Investment Company had income before taxes of $1,000 for the three-month period ended September 30, 2010 compared to $7,000 for the same period in 2009, a decrease of $6,000, or 85.7%. ESI Investment Company had income before taxes of $3,000 for the nine-month period ended September 30, 2010 compared to income before income taxes of $13,000 for the same period in 2009, a decrease of $10,000, or 76.9%. The decrease for the three-month and nine-month period ended September 30, 2010 was due to a decrease in interest income from Treasury Bills.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were $686,000 at September 30, 2010, $746,000 at December 31, 2009, and $677,000 at September 30, 2009.

Cash provided by operating activities was $590,000 and $508,000 for the nine months ended September 30, 2010 and 2009, respectively. The increase was primarily a result of the increase in our net operating income adjusted for changes in accounts receivable, inventories, and accrued income tax activity. Cash from operating activities increased $82,000 for the nine-months ended September 30, 2010 when compared to the same period in 2009 due to a $226,000 increase in net income and a $208,000 increase in trade receivables, offset by a decrease of $396,000 in inventories. The net change in trade receivables was due to a decrease in the balance of $99,000 at September 30, 2010 compared to the prior year increase in the balance of $109,000 at September 30, 2009 when compared to the prior year. The net change in inventories was due to an increase in the balance of $167,000 at September 30, 2010 compared to the prior year decrease in the balance of $229,000 at September 30, 2009 when compared to the prior year.

Cash used for investing activities was $257,000 and $4,966,000 for the nine months ended September 30 2010 and 2009, respectively. The significant decrease in cash used for investing activities was due to purchases of six month Treasury Bills of $9,949,000 in 2009, offset by a sale of Treasury Bills of $4,980,000. During 2010, the purchase of Treasury Bills with a maturity date greater than three months was $10,246,000, offset by sales of Treasury Bills of $10,030,000.

Table of Contents

Cash used for financing activities was $393,000 and $394,000 for the nine months ended September 30, 2010 and 2009, respectively. During the nine-month periods ended September 30, 2010 and 2009, the Company paid aggregate dividends of $405,000 and $404,000, respectively. In 2009, one employee exercised a stock option which provided cash of $2,000. There were no such exercises of stock options in 2010. During the nine-month periods ended September 30, 2010 and 2009, the Company had $12,000 and $8,000, respectively, in stock purchases under the Employee Stock Purchase Plan.

Our ongoing cash requirements will be primarily for capital expenditures, possible acquisitions of companies that have related product lines or technologies, research and development in both the Production Monitoring and AutoData Systems divisions, and working capital. Management believes that cash on hand and any cash provided by operations will be sufficient to meet our cash requirements through at least the next 12 months.

Our primary investments are 343,267 shares of Rudolph Technologies, Inc. (Rudolph), listed on the Nasdaq stock market, 551,759 shares of PPT Vision, Inc. (PPT), listed on the Pink Sheets, and Treasury Bills. The Rudolph investment is accounted for using the available for sale method. The PPT investment is accounted for under the equity method of accounting. The stocks and Treasury Bills are subject to fluctuations in market price and could have a negative effect on our liquidity. It is the Company s intent to hold the Treasury Bills until maturity.

Off-balance Sheet Arrangements

As of September 30, 2010, the Company had no off-balance sheet arrangements or transactions.

FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding our expectations, beliefs, intentions or strategies regarding the future. Forward-looking statements include, but are not limited to, statements relating to our marketing efforts; our intention to hold our Treasury Bills until maturity; our beliefs with respect to the uncertainty of the healthcare industry; management s intention that we not become an investment company; our expected use of cash on hand; our cash requirements; and the sufficiency of our cash flows. Any statement that is not based solely upon historical facts, including strategies for the future and the outcome of events that have not yet occurred, is considered a forward-looking statement.

All forward-looking statements in this document are based on information available to us as of the date hereof, and we assume no obligation to update any such forward-looking statements, other than as required by law. It is important to note that our actual results could differ materially from those in such forward-looking statements. The forward-looking statements we make in this Quarterly Report are subject to certain risks and uncertainties that could cause future results to differ materially from our recent results or those projected in the forward-looking statements, including the accuracy of management s assumptions with respect to industry trends, fluctuations in industry conditions, the impact of any prolonged recessionary conditions or worsening of the global economy, the accuracy of management s assumptions regarding expenses and our cash needs and those listed under the heading Cautionary Statements under Item 1 Business, in our Annual Report on Form 10-K for the year ended December 31, 2009.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not Applicable.

Table of Contents

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company s management, the Company s principal executive officer and principal financial officer have concluded that the Company s disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act) were effective as of September 30, 2010 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company s internal control over financial reporting during the third quarter of 2010, which were identified in connection with management s evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings - None.

Item 1A. Risk Factors - Not Applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds - None.

Item 3. Defaults Upon Senior Securities - None.

Item 4. [Removed and Reserved]

Item 5. Other Information - None.

Item 6. Exhibits

(a) Exhibits - See Exhibit Index following signature page.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Electro-Sensors, Inc.

November 12, 2010

/s/ Bradley D. Slye
Bradley D. Slye
Chief Executive Officer and Chief Financial Officer

Table of Contents

EXHIBIT INDEX

ELECTRO-SENSORS, INC.

FORM 10-Q FOR QUARTER ENDED SEPTEMBER 30, 2010

Exhibit	Description
31.1	Certification of CEO and CFO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002