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**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, 2019**

**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 000-09587**

**ELECTRO-SENSORS, INC.**

(Exact name of registrant as specified in its charter)

**Minnesota**

(State or other jurisdiction of incorporation or  
organization)

**41-0943459**

(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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock	ELSE	Nasdaq Capital Market

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

Large accelerated filer ☐

Non-accelerated filer ☐

Accelerated filer ☐

Smaller reporting company ☒

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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, 2019 was 3,395,521.

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**ELECTRO-SENSORS, INC.**  
**Form 10-Q**  
**For the Periods Ended September 30, 2019**

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

#### ELECTRO-SENSORS, INC. CONDENSED BALANCE SHEETS

(in thousands except share and per share amounts)

	September 30, 2019 (unaudited)	December 31, 2018
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 3,117	\$ 1,057
Investments	5,786	7,742
Trade receivables, less allowance for doubtful accounts of \$11	965	896
Inventories	1,719	1,618
Other current assets	194	155
<b>Total current assets</b>	<b>11,781</b>	<b>11,468</b>
<b>Deferred income tax asset, net</b>	<b>196</b>	<b>192</b>
<b>Intangible assets, net</b>	<b>555</b>	<b>565</b>
<b>Property and equipment, net</b>	<b>1,063</b>	<b>1,050</b>
<b>Total assets</b>	<b>\$ 13,595</b>	<b>\$ 13,275</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Current maturities of financing lease	\$ 5	\$ 5
Accounts payable	196	116
Accrued expenses	510	405
Accrued income tax	30	0
<b>Total current liabilities</b>	<b>741</b>	<b>526</b>
<b>Long-term liabilities</b>		
Financing lease, net of current maturities	20	24
<b>Total long-term liabilities</b>	<b>20</b>	<b>24</b>
<b>Commitments and contingencies</b>		
<b>Stockholders' equity</b>		
Common stock par value \$0.10 per share; authorized 10,000,000 shares; 3,395,521 shares issued and outstanding	339	339
Additional paid-in capital	2,027	2,019
Retained earnings	10,426	10,335
Accumulated other comprehensive gain (unrealized gain on available-for-sale securities, net of income tax)	42	32
<b>Total stockholders' equity</b>	<b>12,834</b>	<b>12,725</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 13,595</b>	<b>\$ 13,275</b>

See accompanying notes to unaudited condensed financial statements

**ELECTRO-SENSORS, INC.**  
**CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
(in thousands except share and per share amounts)  
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30	
	2019	2018	2019	2018
<b>Net sales</b>	<b>\$ 2,049</b>	<b>\$ 2,146</b>	<b>\$ 6,317</b>	<b>\$ 5,642</b>
<b>Cost of goods sold</b>	<b>975</b>	<b>951</b>	<b>2,941</b>	<b>2,559</b>
<b>Gross profit</b>	<b>1,074</b>	<b>1,195</b>	<b>3,376</b>	<b>3,083</b>
<b>Operating expenses</b>				
Selling and marketing	494	406	1,495	1,242
General and administrative	404	414	1,294	1,370
Research and development	194	176	603	628
<b>Total operating expenses</b>	<b>1,092</b>	<b>996</b>	<b>3,392</b>	<b>3,240</b>
<b>Operating income (loss)</b>	<b>(18)</b>	<b>199</b>	<b>(16)</b>	<b>(157)</b>
<b>Non-operating income (expense)</b>				
Interest expense	0	0	(1)	0
Interest income	41	36	126	83
Other income	2	2	7	7
<b>Total non-operating income, net</b>	<b>43</b>	<b>38</b>	<b>132</b>	<b>90</b>
<b>Income (loss) before income tax expense (benefit)</b>	<b>25</b>	<b>237</b>	<b>116</b>	<b>(67)</b>
<b>Provision for (benefit of) income tax</b>	<b>6</b>	<b>50</b>	<b>25</b>	<b>(9)</b>
<b>Net income (loss)</b>	<b>\$ 19</b>	<b>\$ 187</b>	<b>\$ 91</b>	<b>\$ (58)</b>
<b>Other comprehensive income</b>				
Change in unrealized value of available-for-sale securities, net of income tax	\$ 2	\$ 0	\$ 10	\$ 7
<b>Other comprehensive income</b>	<b>2</b>	<b>0</b>	<b>10</b>	<b>7</b>
<b>Net comprehensive income (loss)</b>	<b>\$ 21</b>	<b>\$ 187</b>	<b>\$ 101</b>	<b>\$ (51)</b>
<b>Net income (loss) per share data:</b>				
<b>Basic</b>				
Net income (loss) per share	\$ 0.01	\$ 0.06	\$ 0.03	\$ (0.02)
Weighted average shares	3,395,521	3,395,521	3,395,521	3,395,521
<b>Diluted</b>				
Net income (loss) per share	\$ 0.01	\$ 0.06	\$ 0.03	\$ (0.02)
Weighted average shares	3,398,533	3,398,238	3,397,385	3,395,521

See accompanying notes to unaudited condensed financial statements

**ELECTRO-SENSORS, INC.**  
**CONDENSED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
(in thousands except share and per share amounts)

**For the three months ended September 30**

	<b>Common Stock Issued</b>		<b>Additional Paid-in Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Total Stockholders' Equity</b>
	<b>Shares</b>	<b>Amount</b>				
June 30, 2019	3,395,521	\$ 339	\$ 2,024	\$ 10,407	\$ 40	\$ 12,810
Other comprehensive income					2	2
Stock-based compensation expense			3			3
Net income				19		19
<b>Balance September 30, 2019 (unaudited)</b>	<b><u>3,395,521</u></b>	<b><u>\$ 339</u></b>	<b><u>\$ 2,027</u></b>	<b><u>\$ 10,426</u></b>	<b><u>\$ 42</u></b>	<b><u>\$ 12,834</u></b>
June 30, 2018	3,395,521	\$ 339	\$ 2,010	\$ 10,100	\$ 26	\$ 12,475
Other comprehensive income					0	0
Stock-based compensation expense			1			1
Net income				187		187
<b>Balance September 30, 2018 (audited)</b>	<b><u>3,395,521</u></b>	<b><u>\$ 339</u></b>	<b><u>\$ 2,011</u></b>	<b><u>\$ 10,287</u></b>	<b><u>\$ 26</u></b>	<b><u>\$ 12,663</u></b>

**For the nine months ended September 30**

	<b>Common Stock Issued</b>		<b>Additional Paid-in Capital</b>	<b>Retained Earnings</b>	<b>Accumulated Other Comprehensive Income</b>	<b>Total Stockholders' Equity</b>
	<b>Shares</b>	<b>Amount</b>				
December 31, 2018	3,395,521	\$ 339	\$ 2,019	\$ 10,335	\$ 32	\$ 12,725
Other comprehensive income					10	10
Stock-based compensation expense			8			8
Net income				91		91
<b>Balance, September 30, 2019 (unaudited)</b>	<b><u>3,395,521</u></b>	<b><u>\$ 339</u></b>	<b><u>\$ 2,027</u></b>	<b><u>\$ 10,426</u></b>	<b><u>\$ 42</u></b>	<b><u>\$ 12,834</u></b>
December 31, 2017	3,395,521	\$ 339	\$ 2,004	\$ 10,352	\$ 12	\$ 12,707
Other comprehensive income					7	7
Stock-based compensation expense			7			7
Change in accounting policy				(7)	7	0
Net loss				(58)		(58)
<b>Balance, September 30, 2018 (unaudited)</b>	<b><u>3,395,521</u></b>	<b><u>\$ 339</u></b>	<b><u>\$ 2,011</u></b>	<b><u>\$ 10,287</u></b>	<b><u>\$ 26</u></b>	<b><u>\$ 12,663</u></b>

See accompanying notes to unaudited condensed financial statements

**ELECTRO-SENSORS, INC.**  
**CONDENSED STATEMENTS OF CASH FLOWS**  
(in thousands)  
(unaudited)

	Nine Months Ended September 30,	
	2019	2018
<b>Cash flows from (used in) operating activities</b>		
<b>Net income (loss)</b>	<b>\$ 91</b>	<b>\$ (58)</b>
Adjustments to reconcile net income (loss) to net cash from (used in) operating activities:		
Depreciation and amortization	231	238
Deferred income taxes	(6)	0
Stock-based compensation expense	8	7
Interest accrued on treasury bills	(120)	(78)
Change in:		
Trade receivables	(69)	(142)
Inventories	(101)	(52)
Other current assets	(39)	(30)
Accounts payable	80	15
Accrued expenses	105	45
Income tax receivable/payable	30	28
<b>Net cash from (used in) operating activities</b>	<b>210</b>	<b>(27)</b>
<b>Cash flows from investing activities</b>		
Purchases of treasury bills	(7,662)	(10,654)
Proceeds from the maturity of treasury bills	9,750	10,750
Purchase of intangible asset	(150)	0
Purchase of property and equipment	(84)	(29)
<b>Net cash from investing activities</b>	<b>1,854</b>	<b>67</b>
<b>Cash flows used in financing activities</b>		
Payments on financing lease	(4)	0
Payment of contingent earn-out	0	(150)
<b>Net cash used in financing activities</b>	<b>(4)</b>	<b>(150)</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>2,060</b>	<b>(110)</b>
Cash and cash equivalents, beginning	1,057	963
Cash and cash equivalents, ending	<u>\$ 3,117</u>	<u>\$ 853</u>
<b>Supplemental cash flow information</b>		
Cash paid for income taxes	<u>\$ 1</u>	<u>\$ 0</u>
Cash paid for interest	<u>\$ 1</u>	<u>\$ 0</u>

See accompanying notes to unaudited condensed financial statements

**ELECTRO-SENSORS, INC.**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**  
**FOR THE PERIOD ENDED SEPTEMBER 30, 2019**  
**(in thousands except share and per share amounts)**  
(unaudited)

**Note 1. Basis of Presentation**

The accompanying unaudited 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, 2018, including the audited financial statements and footnotes therein.

Management believes that the unaudited financial statements include all adjustments, consisting of normal recurring accruals, necessary to fairly state the financial position and results of operations as of September 30, 2019 and for the three and nine-month periods then ended in accordance with accounting principles generally accepted in the United States of America. The results of interim periods may not be indicative of results to be expected for the year.

**Nature of Business**

Electro-Sensors, Inc. manufactures and markets a complete line of monitoring and control systems for a variety of industrial machinery. The Company uses leading-edge technology to continuously improve its products and expand the number of applications they can be used in, with the goal of manufacturing the industry-preferred product for every market served. The Company sells these products through an internal sales staff, manufacturers' representatives, and distributors to a wide variety of industries that use the products in a variety of applications to monitor process machinery operations. The Company markets its products to customers located throughout the United States, Canada, Latin America, Europe, and Asia.

**Revenue Recognition**

At contract inception, the Company assesses the goods and services promised to a customer and identifies a performance obligation for each distinct promised good or service. We also determine the transaction price for each performance obligation at contract inception. Our contracts, generally in the form of a purchase order, specify the product or service that is promised to the customer. The typical contract life is less than one month and contains a single performance obligation, to provide conforming goods or services to the customer. On some contracts, we have a second performance obligation, which typically is the initialization of the HazardPRO™ product. For contracts that have multiple performance obligations, we allocate the transaction price to each performance obligation using the relative stand-alone selling price. We generally determine stand-alone selling prices based on the observable stand-alone prices charged to customers. We recognize product revenue at the point in time when control of the product is transferred to the customer, which typically occurs when we ship the products. We recognize service revenue at the point in time when we have provided the service.

**Fair Value Measurements**

The carrying value of trade receivables, accounts payable, and other financial working capital items approximates fair value at September 30, 2019 and December 31, 2018, due to the short maturity nature of these instruments.



**ELECTRO-SENSORS, INC.**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**  
**FOR THE PERIOD ENDED SEPTEMBER 30, 2019**  
**(in thousands except share and per share amounts)**  
(unaudited)

**Intangibles**

Intangible assets are comprised of a non-compete agreement, the HazardPRO technology, and a technology license. The Company amortizes the cost of these intangible assets on a straight-line method over their estimated useful lives.

On September 30, 2019, the Company purchased a royalty-free, perpetual technology license for wireless communication technologies for \$150.

**Stock-Based Compensation**

The Company records compensation expense for stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes-Merton ("BSM") option pricing 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 interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option.

As of September 30, 2019, there was approximately \$17 of unrecognized compensation expense related to unvested stock options. The Company expects to recognize this expense over the next three years.

**Use of Estimates**

The preparation of 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 financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates, including the underlying assumptions, consist of economic lives of long-lived assets, realizability of trade receivables, valuation of deferred tax assets/liabilities, inventory, investments, contingent earn-out, and stock compensation expense. It is at least reasonably possible that these estimates may change in the near term.

**Net Income (Loss) per Common Share**

Basic and diluted net income (loss) per common share is determined by dividing net income (loss) attributable to common stockholders by the weighted-average common shares outstanding during the period. For the three and nine-month periods ended September 30, 2018, the common shares underlying stock options have been excluded from the calculation because their effect would be anti-dilutive. Therefore, the weighted-average shares outstanding used to calculate both basic and diluted loss per common shares are the same.

For the three and nine months ended September 30, 2019, options to purchase 329,488 and 330,636 weighted-average common shares, respectively, have been excluded from the computations of diluted weighted-average shares outstanding because their effect would be anti-dilutive. For the three and nine months ended September 30, 2018, options to purchase 304,783 and 307,500 weighted-average common shares, respectively, have been excluded from the computations of diluted weighted-average shares outstanding because their effect would be anti-dilutive.

**ELECTRO-SENSORS, INC.**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**  
**FOR THE PERIOD ENDED SEPTEMBER 30, 2019**  
(in thousands except share and per share amounts)  
(unaudited)

**Note 2. Investments**

The Company has investments in commercial paper, Treasury Bills, and common equity securities of a private U.S. company. The commercial paper investment is in U.S. debt with ratings of A-1+, P-1, and F1+. The Treasury Bills have remaining terms ranging from one month to three months at September 30, 2019.

The Company classifies its investments in commercial paper and Treasury Bills as available-for-sale, accounted for at fair value with unrealized gains and losses recognized in accumulated other comprehensive gain on the balance sheet.

Prior to January 1, 2018, the Company accounted for equity securities at fair value with unrealized gains and losses recognized in accumulated other comprehensive gain on the balance sheet. Realized gains and losses on equity securities sold or impaired were recognized in non-operating income on the statement of comprehensive income (loss).

On January 1, 2018, the Company adopted ASU 2016-01, which changed how the Company accounted for equity securities. Equity securities are now measured at fair value and starting January 1, 2018, unrealized gains and losses have been recognized in non-operating income. Upon adoption, the Company reclassified \$7 of net unrealized losses related to equity securities from accumulated other comprehensive gain to retained earnings.

The cost and estimated fair value of the Company's investments are as follows:

	Cost	Gross unrealized gain	Gross unrealized loss	Fair value
<b>September 30, 2019</b>				
Commercial Paper	\$ 810	\$ 0	\$ 0	\$ 810
Treasury Bills	7,684	56	0	7,740
Equity Securities	45	0	0	45
	8,539	56	0	8,595
Less Cash Equivalents	2,809	0	0	2,809
<b>Total Investments, September 30, 2019</b>	<u>\$ 5,730</u>	<u>\$ 56</u>	<u>\$ 0</u>	<u>\$ 5,786</u>
<b>December 31, 2018</b>				
Commercial Paper	\$ 667	\$ 0	\$ 0	\$ 667
Treasury Bills	7,656	41	0	7,697
Equity Securities	45	0	0	45
	8,368	41	0	8,409
Less Cash Equivalents	667	0	0	667
<b>Total Investments, December 31, 2018</b>	<u>\$ 7,701</u>	<u>\$ 41</u>	<u>\$ 0</u>	<u>\$ 7,742</u>

**ELECTRO-SENSORS, INC.**  
**NOTES TO CONDENSED FINANCIAL STATEMENTS**  
**FOR THE PERIOD ENDED SEPTEMBER 30, 2019**  
(in thousands except share and per share amounts)  
(unaudited)

**Note 3. Fair Value Measurements**

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

**September 30, 2019**

	Carrying amount		Fair Value Measurement Using		
	in balance sheet	Fair Value	Level 1	Level 2	Level 3
<b>Assets:</b>					
Cash equivalents					
Commercial paper	\$ 810	\$ 810	\$ 810	\$ 0	\$ 0
Treasury bills	1,999	1,999	1,999	0	0
Treasury bills	5,741	5,741	5,741	0	0
Equity Securities	45	45	0	0	45

**December 31, 2018**

	Carrying amount		Fair Value Measurement Using		
	in balance sheet	Fair Value	Level 1	Level 2	Level 3
<b>Assets:</b>					
Cash equivalents					
Commercial paper	\$ 667	\$ 667	\$ 667	\$ 0	\$ 0
Treasury bills	7,697	7,697	7,697	0	0
Equity Securities	45	45	0	0	45

The fair value of the commercial paper and treasury bills is based on quoted market prices in an active market. There is no public market for the available-for-sale equity security owned by the Company. The Company has determined the fair value for this equity security based on financial and other factors that are considered level 3 inputs in the fair value hierarchy.

The change in level 3 liabilities at fair value on a recurring basis for the nine months ended September 30, 2018 relate to the Harvest Engineering contingent earn-out and are as follows:

	<u>Nine Months Ended September 30, 2018</u>
Beginning Balance	\$ 150
Change in Fair Value	0
Payments	(150)
Ending Balance	<u>\$ 0</u>

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

### **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 efforts to accelerate future growth or income; our business development activities; our efforts to maintain or reduce production costs; 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 our strategies for the future and the outcome of events that have not yet occurred, is a forward-looking statement.

All forward-looking statements in this document are based on information available to us as of the date of this Form 10-Q, and we assume no obligation to update any of these forward-looking statements, other than as required by law. Our actual results could differ materially from those projected or indicated in these forward-looking statements. These forward-looking statements 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 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, 2018.

### **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. These decisions include the selection of applicable accounting principles and the use of judgment in their application and affect 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, 2018. We have not developed new estimates subsequent to those discussed in our Annual Report.

## SELECTED FINANCIAL INFORMATION

The following table contains selected financial information, for the periods indicated, from our statements of comprehensive income (loss) expressed as a percentage of net sales.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net sales	100.0 %	100.0 %	100.0 %	100.0 %
Cost of goods sold	47.6	44.3	46.6	45.4
Gross profit	52.4	55.7	53.4	54.6
Operating expenses				
Selling and marketing	24.1	18.9	23.6	22.0
General and administrative	19.7	19.3	20.5	24.3
Research and development	9.5	8.2	9.5	11.1
Total operating expenses	53.3	46.4	53.6	57.4
Operating income (loss)	(0.9)	9.3	(0.2)	(2.8)
Non-operating income (expense)				
Interest income	2.0	1.7	2.0	1.5
Other income	0.1	0.0	0.1	0.1
Total non-operating income, net	2.1	1.7	2.1	1.6
Income (loss) before income tax expense (benefit)	1.2	11.0	1.9	(1.2)
Provision for (benefit from) income taxes	0.3	2.3	0.4	(0.2)
Net income (loss)	0.9 %	8.7 %	1.5 %	(1.0)%

The following paragraphs discuss the Company's performance for the three and nine months ended September 30, 2019 and 2018.

## RESULTS OF OPERATIONS (in thousands)

### Net Sales

Net sales for the three-month period ended September 30, 2019 were \$2,049, a decrease of \$97, or 4.5%, from \$2,146 during the comparable period in 2018. Net sales for the nine months ended September 30, 2019 were \$6,317, an increase of \$675, or 12.0%, over the corresponding period in 2018. The year-to-date sales increase has been primarily driven by increased sales of HazardPRO wireless monitoring systems. Additionally, international sales increased by 51% for the nine-month period, reaching 14.5% of sales as compared to 10.5% during the similar period in 2018, primarily driven by higher sales into Canada.

### Gross Profit

Gross profit for the third quarter of 2019 decreased \$121, or 10.1%, over the same period in 2018. Gross profit for the nine months ended September 30, 2019 increased \$293, or 9.5%, over the same period in 2018. Gross margin decreased in the third quarter of 2019 to 52.4% from 55.7% during the same period in 2018. Gross margin decreased in the nine months ended September 30, 2019 to 53.4%, versus 54.6% in the same period in 2018. The decrease in the gross margin percentage for both periods was primarily due to a change in product mix and higher material costs resulting from the increase in government tariff charges.

### **Operating Expenses**

Total operating expenses increased \$96, or 9.6%, for the third quarter of 2019 compared to the same period in 2018 and increased as a percentage of net sales to 53.3% from 46.4%. Total operating expenses increased \$152, or 4.7%, for the nine months ended September 30, 2019 compared to the same period in 2018 but decreased as a percentage of net sales to 53.6% from 57.4%.

- Selling and marketing expenses in the third quarter of 2019 increased \$88, or 21.7%, from the same period in 2018 and increased as a percentage of net sales to 24.1% from 18.9%. Selling and marketing expenses in the nine months ended September 30, 2019 increased \$253, or 20.4%, from the same period in 2018 and increased as a percentage of net sales to 23.6% from 22.0%. The increase for both periods resulted primarily from increased headcount, higher internal sales staff compensation due to increased sales and changes in compensation plans.
- General and administrative expenses decreased \$10, or 2.4%, for the third quarter of 2019 compared to the same period in 2018 but increased slightly as a percentage of net sales to 19.7% from 19.3%. General and administrative expenses decreased \$76, or 5.5%, for the nine months ended September 30, 2019 compared to the same period in 2018 and decreased as a percentage of net sales to 20.5% from 24.3%. The decrease in the third quarter was due primarily to decreased expenses related to computer supplies, software, and training and lower compensation costs due to a decrease in headcount in 2019, partially offset by an increase in legal fees related to 2019 business development activities. The decrease for the nine-month period was due primarily to lower legal fees and lower compensation costs due to a decrease in headcount in 2019.
- Research and development expenses increased \$18, or 10.2%, in the third quarter of 2019 from the same period in 2018 and increased as a percentage of net sales to 9.5% from 8.2%. Research and development expenses decreased \$25, or 4.0%, in the nine months ended September 30, 2019 from the same period in 2018 and decreased as a percentage of net sales to 9.5% from 11.1%. The increase in the third quarter was due to higher 2019 contract engineering costs related to product enhancements. The decrease in the nine-month period was due to decreased lab testing, certification and lab material expenses for new products compared to the first nine months of last year.

### **Non-Operating Income (Net)**

Net non-operating income increased by \$5, or 13.2%, for the third quarter of 2019 compared to the same period in 2018. Net non-operating income increased by \$42, or 46.7%, for the nine months ended September 30, 2019 compared to the same period in 2018. The increase was primarily due to higher interest income earned from higher interest rates on Treasury Bills.

### **Income (Loss) Before Income Tax Expense (Benefit)**

Income before income tax expense was \$25 for the third quarter of 2019, representing a decrease in the third quarter income of \$212, or 89.5%, compared to \$237 for the same period in 2018. Income before income tax expense was \$116 for the nine months ended September 30, 2019, representing an increase in income of \$183, or 273.1%, compared to a loss before income tax benefit of \$67 for the same period in 2018. The decrease in income in the 2019 three-month period was primarily the result of lower third quarter net sales, while the increase in the nine-month period was primarily the result of higher 2019 net sales, in each case as discussed above.

### **Income Taxes**

The Company's income tax expense percentage increased to 24.0% for the third quarter of 2019 from 21.1% of income tax benefit in the third quarter of 2018. The Company's income tax expense percentage increased to 21.6% for the nine months ended September 30, 2019 from 13.4% of income tax benefit in the nine months ended September 30, 2018.

## **LIQUIDITY AND CAPITAL RESOURCES**

Cash and cash equivalents were \$3,117 at September 30, 2019 and \$1,057 at December 31, 2018. The increase was primarily the result of cash generated from investing activities due to the maturity of treasury bills. Some of the treasury bills purchased during the third quarter of 2019 were considered cash equivalents.

Cash generated from operating activities was \$210 for the nine months ended September 30, 2019 as compared to cash used in operating activities of \$27 for the nine months ended September 30, 2018. The \$237 increase in cash from operations was due to net income in 2019 compared to a net loss in 2018, a decrease in trade receivables, an increase in accounts payable, and an increase in accrued expenses, partially offset by an increase in inventory. The 2019 net income, as compared to the prior year net loss, was primarily due to increased net sales. The decrease in trade receivables is due the timing of sales and collections on accounts. The increase in accounts payable is due to timing of payments. The increase in accrued expenses is due to increased headcount and changes in compensation plans. The increase in inventory is due to the timing of purchases.

Cash generated from investing activities was \$1,854 and \$67 for the nine months ended September 30, 2019 and 2018, respectively. During the nine months ended September 30, 2019 and 2018, the Company had net proceeds from maturities of Treasury Bills of \$2,088 and \$96, respectively. In addition, we purchased \$234 and \$29 of property, equipment, and intangibles during the nine months ended 2019 and 2018, respectively.

Cash used in financing activities in the nine months ended September 30, 2019 and 2018 was \$4 and \$150, respectively. The cash used in 2019 was for principal payments on a financing lease on right-to-use assets. The cash used in 2018 was for the final payment on the contingent earn-out owed for the technology purchased from Harvest Engineering, Inc. in 2014.

Our ongoing cash requirements will be primarily for capital expenditures, research and development, working capital, and growth initiatives. Management believes that our cash on hand and any cash generated from operations will be sufficient to meet our cash requirements through at least the next 12 months.

### ***Future Business Development Activities***

The Company continues to seek growth opportunities, both internally through the Company's existing portfolio of products, technologies and markets, as well as externally through technology partnerships or related-product acquisitions.

### ***Off-balance Sheet Arrangements***

As of September 30, 2019, the Company had no off-balance sheet arrangements or transactions.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Not Applicable.

### **Item 4. Controls and Procedures**

#### ***Evaluation of Disclosure Controls and Procedures***

Based on an evaluation with the participation of the Company's management, the Company's principal executive officer and principal financial officer has 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, 2019.

#### ***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 2019 that 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. Mine Safety Disclosures – Not Applicable**

**Item 5. Other Information – None**

**Item 6. Exhibits**

<b>Exhibit</b>	<b>Description</b>
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.
101	The following financial information from Electro-Sensors, Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2019, formatted in iXBRL (Inline Extensible Business Reporting Language), (i) Condensed Balance Sheets as of September 30, 2019 and December 31, 2018, (ii) Condensed Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2019 and September 30, 2018, (iii) Condensed Statements of Cash Flows for the nine months ended September 30, 2019 and September 30, 2018, (iv) Condensed Statements of Changes in Stockholders' Equity for the three and nine months ended September 30, 2019 and September 30, 2018, and (v) Notes to Financial Statements.

## **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, 2019

/s/ David L. Klenk

David L. Klenk  
Chief Executive Officer and Chief Financial Officer  
(Principal Executive Officer and Principal Financial  
Officer)

**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES OXLEY-ACT OF 2002**

I, David L. Klenk, certify that:

1. I have reviewed this report on Form 10-Q of Electro-Sensors Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant is made known to me by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

November 12, 2019

/s/ David L. Klenk

David L. Klenk  
Chief Executive Officer and Chief Financial Officer

**CERTIFICATION PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Electro-Sensors, Inc. (the “Company”) on Form 10-Q for the quarter ended September 30, 2019 as filed with the Securities and Exchange Commission (the “Report”), I, David L. Klenk, Chief Executive Officer and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

November 12, 2019

\_\_\_\_\_  
/s/ David L. Klenk  
David L. Klenk  
Chief Executive Officer and Chief Financial Officer