

ELECTRO SENSORS INC
Form 10QSB
May 16, 2005

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

Form 10-QSB

**ý QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2005

**o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE
EXCHANGE ACT**

FOR THE TRANSITION PERIOD FROM TO

Commission File Number 0-9587

ELECTRO-SENSORS, INC.

(Exact name of small business issuer as specified in its charter)

Minnesota

41-0943459

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(State or other jurisdiction of incorporation or
organization)

(IRS Employer Identification No.)

**6111 Blue Circle Drive
Minnetonka, Minnesota 55343-9108**

Edgar Filing: ELECTRO SENSORS INC - Form 10QSB

(Address of principal executive offices)

(952) 930-0100

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(Issuer's telephone number)

Check whether the issuer (1) 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

The number of shares outstanding of the registrant's Common Stock, \$0.10 par value, on May 16, 2005 was 3,228,962.

Transitional Small Business Disclosure Format (check one): Yes No

ELECTRO-SENSORS, INC.

Form 10-QSB

For the Period Ended March 31, 2005

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ELECTRO-SENSORS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

| | March 31, 2005 (unaudited) | December 31, 2004 (audited) |
|--|----------------------------------|-----------------------------------|
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 6,516,000 | \$ 6,464,000 |
| Available for sale securities | 8,009,000 | 7,334,000 |
| Trade receivables, less allowance for doubtful accounts of \$9,000 and \$6,000, respectively | 567,000 | 559,000 |
| Inventories | 822,000 | 810,000 |
| Prepaid income tax | 100,000 | 127,000 |
| Other current assets | 67,000 | 68,000 |
| Total current assets | 16,081,000 | 15,362,000 |
| PROPERTY AND EQUIPMENT, net | 1,400,000 | 1,402,000 |
| INVESTMENT IN EQUITY METHOD INVESTEE | 129,000 | 140,000 |
| TOTAL ASSETS | \$ 17,610,000 | \$ 16,904,000 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 202,000 | \$ 162,000 |
| Accrued expenses | 302,000 | 248,000 |
| Deferred revenue | 71,000 | 68,000 |
| Deferred income tax | 2,880,000 | 2,623,000 |
| Total current liabilities | 3,455,000 | 3,101,000 |
| COMMITMENTS AND CONTINGENCIES (Notes 6 and 8) | | |
| STOCKHOLDERS EQUITY | | |
| Common stock par value \$0.10 per share; authorized 10,000,000 shares; issued and outstanding 3,222,212 and 3,218,345 shares, respectively | 322,000 | 322,000 |
| Additional paid-in capital | 1,114,000 | 1,104,000 |
| Retained earnings | 7,887,000 | 7,964,000 |
| Accumulated other comprehensive income | 4,832,000 | 4,413,000 |
| Total stockholders equity | 14,155,000 | 13,803,000 |

| | | | | |
|--|-----------|-------------------|-----------|-------------------|
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ | 17,610,000 | \$ | 16,904,000 |
|--|-----------|-------------------|-----------|-------------------|

See notes to consolidated financial statements

ELECTRO-SENSORS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|-------------------|
| | 2005 | 2004 |
| Net sales | \$ 1,204,000 | \$ 1,216,000 |
| Cost of goods sold | 445,000 | 466,000 |
| Gross profit | 759,000 | 750,000 |
| Operating expenses: | | |
| Selling and marketing | 308,000 | 315,000 |
| General and administrative | 329,000 | 321,000 |
| Research and development | 204,000 | 171,000 |
| Total operating expenses | 841,000 | 807,000 |
| Operating loss | (82,000) | (57,000) |
| Non-operating income (expense): | | |
| Gain on sale of investment securities | 135,000 | 324,000 |
| Interest income | 32,000 | 11,000 |
| Other income | 4,000 | 3,000 |
| Equity in losses of equity method investee | (11,000) | (65,000) |
| Total non-operating income (expense) | 160,000 | 273,000 |
| Income before income taxes | 78,000 | 216,000 |
| Federal and state income taxes | 27,000 | 113,000 |
| Net income | \$ 51,000 | \$ 103,000 |
| Net income per share data: | | |
| Basic | | |
| Net income (loss) per share | \$ 0.02 | \$ 0.03 |
| Weighted average shares | 3,219,664 | 3,181,117 |
| Diluted | | |
| Net income (loss) per share | \$ 0.02 | \$ 0.03 |
| Weighted average shares | 3,319,730 | 3,300,097 |
| Dividends paid per share | \$ 0.04 | \$ 0.04 |

See notes to consolidated financial statements

ELECTRO-SENSORS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|------------------|
| | 2005 | 2004 |
| Cash flows from operating activities | | |
| Net income | \$ 51,000 | \$ 103,000 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation | 24,000 | 22,000 |
| Realized gain on sale of investments | (135,000) | (324,000) |
| Equity in loss of equity method investee | 11,000 | 65,000 |
| (Increase)/decrease in: | | |
| Trade receivables | (8,000) | (24,000) |
| Inventory | (12,000) | (43,000) |
| Other current assets | 1,000 | (4,000) |
| Prepaid income taxes | 27,000 | 0 |
| Accounts payable | 40,000 | 38,000 |
| Accrued expenses | 54,000 | (55,000) |
| Deferred revenue | 3,000 | 6,000 |
| Accrued income taxes | 0 | 13,000 |
| Net cash provided by/(used in) operating activities | 56,000 | (203,000) |
| Cash flows from investing activities: | | |
| Proceeds from sale of investments | 136,000 | 449,000 |
| Purchase of equity securities | 0 | (116,000) |
| Purchase of property and equipment | (22,000) | 0 |
| Net cash provided by investing activities | 114,000 | 333,000 |
| Cash flows from financing activities: | | |
| Proceeds from issuance of stock | 10,000 | 30,000 |
| Dividends paid | (128,000) | (127,000) |
| Net cash used in financing activities | (118,000) | (97,000) |
| Net increase/decrease in cash & cash equivalents | 52,000 | 33,000 |
| Cash & cash equivalents, beginning | 6,464,000 | 6,863,000 |
| Cash & cash equivalents, ending | \$ 6,516,000 | \$ 6,896,000 |
| Supplemental schedule of non-cash investing and financing activities | | |
| Net change in unrealized gain/ (loss) on investments | \$ (676,000) | \$ (2,662,000) |

See accompanying notes to consolidated financial statements

ELECTRO-SENSORS, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Nature of Business

The accompanying consolidated financial statements include the accounts of Electro-Sensors, Inc. and its wholly owned subsidiaries, ESI Investment Company and Senstar Corporation. Senstar Corporation does not have any business transactions. 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 Controls Division, which manufactures and markets a complete line of speed monitoring and motor control systems for industrial machinery. The Controls Division utilizes leading-edge technology to continuously improve its products and make them easier to use. The Controls 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, OEM's and processors to monitor process machinery operations. The Controls Division markets its products to a number of different industries located throughout the United States and abroad.

The second business is AutoData® Systems (ADS). ADS designs and markets a desktop software based system that reads hand printed characters, checkmarks and bar code information from scanned or faxed forms. ADS 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.

ESI Investment Company (INV) owns marketable securities which have experienced significant appreciation in value since the IPO of August Technology in 2000. August Technology Corporation designs, manufactures, and sells automated defect inspection systems used in the manufacture of microelectronic devices. The Company has recognized income from the sale of its holdings in August Technology Corporation. See Note 6 for additional information regarding its investments. The Company's investments in marketable securities are subject to normal market risks.

Note 2. Basis of Presentation

The accompanying unaudited 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 to Form 10-QSB. 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. 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 months ended March 31, 2005 and March 31, 2004. The results of interim periods may not be indicative of results to be expected for the year.

The Balance Sheet at December 31, 2004 has been derived from the Company's audited financial statements for the year ended December 31, 2004, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. For further information, refer to the financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the year ended December 31, 2004.

Note 3. Revenue Recognition

Revenue recognition of production monitoring equipment:

In recognizing revenue, the Company applies the provisions of the Securities and Exchange Commission Staff Accounting Bulletin (SAB) No. 101 (as amended by SAB No. 104), Revenue Recognition. The Company recognizes revenue from the sale of its products 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.

Software revenue recognition:

The Company recognizes revenue upon shipment of its character recognition 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. In some situations, the Company receives advance payments from its customers. Revenue associated with these advance payments is deferred until the product is shipped. ADS customers pay an annual maintenance fee for software support, which is recognized as deferred revenue on the balance sheet and on a monthly basis, it is recognized as revenue over the life of the contract.

Note 4. Stock-Based Compensation

The Company uses the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for employee stock options. Under the intrinsic value method, compensation expense is recorded only to the extent that the market price of the common stock exceeds the exercise price of the stock option on the date of grant.

In December 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. SFAS No. 148 is an amendment to SFAS No. 123 providing alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation and also provides requires additional disclosures about the method of accounting for stock-based employee compensation. The amendments are effective for financial statements for fiscal years ending after December 31, 2002 and for the interim periods beginning after December 15, 2002. The Company adopted the annual disclosure provision of SFAS No. 148 and chose not to adopt the voluntary change to the fair value based method of accounting for stock-based employee compensation, pursuant to SFAS No. 148. The company's policy is to grant stock options at the fair market value on the date of grant.

The Company has adopted the disclosure-only provisions of SFAS No. 148, Accounting for Stock-Based Compensation. Accordingly, no compensation cost has been recognized with respect to stock options. Had compensation cost for stock options been determined based on the fair value methodology prescribed by SFAS 123, the Company's net loss and net loss per share would have been reduced to the pro forma amounts indicated below:

| | 2005 | Three Months Ended March 31, | 2004 |
|---|------|------------------------------------|------------|
| Net income (loss): | | | |
| As reported | \$ | 51,000 | \$ 103,000 |
| Pro forma | \$ | 37,000 | \$ 98,000 |
| Basic net income (loss) per common share: | | | |
| As reported | \$ | 0.02 | \$ 0.03 |
| Pro forma | \$ | 0.01 | \$ 0.03 |
| Diluted net income (loss) per common share: | | | |
| As reported | \$ | 0.02 | \$ 0.03 |
| Pro forma | \$ | 0.01 | \$ 0.03 |
| Stock based compensation: | | | |
| As reported | | 0 | 0 |
| Pro forma | \$ | 14,000 | \$ 5,000 |

The company did not grant any options during the three-months ended March 31, 2005 and March 31, 2004.

Note 5. Net Income Per Share

The Company's basic net income per share amounts have been computed by dividing net income by the weighted average number of outstanding common shares. The Company's diluted net income per share is computed by dividing net income by the weighted average number of

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outstanding common shares and common share equivalents relating to stock options and warrants, when dilutive. For the three months ended March 31, 2005, 100,066 shares of common stock equivalents were included in the computation of diluted net income per share. For the three months ended March 31, 2004, 118,980 shares of common stock equivalents were included in the computation of diluted net income per share.

Options to purchase 9,000 shares of common stock with a weighted average exercise price of \$4.49 were outstanding for the three months ending March 31, 2005, but were excluded from the computation of common share equivalents because their exercise prices were greater than the average market price of the common shares for the period.

Note 6. Investments

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INV's investments consist of equity securities, primarily common stocks, government debt securities and money market funds. The estimated fair value of publicly traded equity securities (other than those accounted for based upon the equity method of accounting) is based on quoted market prices, and therefore subject to the inherent risk of market fluctuations. Shares of common stock for which there is no readily determinable value (i.e., no quoted market price) are accounted for on a historical cost method (unless accounted for based upon the equity method of accounting). 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 buy 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.

The Company's significant investment in equity securities is 657,765 shares of August Technology Corporation whose shares are traded on the Nasdaq Stock Exchange with a March 31, 2005 market value of approximately \$7,709,000 with an approximate cost of \$66,000.

Investment Reported on Equity Method:

At March 31, 2005, the Company owned 2,207,036 shares of PPT, which is approximately 18.4% of PPT's outstanding common stock. The fair value of its holdings based on the quoted market price at March 31, 2005 was approximately \$1,302,000 with an approximate cost of \$2,434,000.

Since the Company owns approximately 18.4% of PPT's outstanding stock, and the Company's Secretary, Peter R Peterson owns approximately 21.6% of PPT's outstanding stock, 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 net income or loss is included in the Company's net income (loss) with a corresponding increase or decrease in the carrying value of its investment. Losses in excess of invested amounts are not recognized in the financial statements, but rather are suspended and applied against future equity in earnings for the investee until exhausted. At March 31, 2005, the Company had approximately \$810,000 in suspended losses from its investment in PPT that will be used to offset future recognition of equity method earnings from the investment.

In April 2004, INV purchased 20% of a la mode, LLC's outstanding membership interests for \$160,000. The Company has adopted the equity method of accounting for this investment.

Under the equity method of accounting, the Company's proportionate share of a la mode's loss is included in the Company's net income with a corresponding decrease in the carrying value of its investment.

Note 7. Comprehensive Income

Comprehensive income includes the Company's net income plus other comprehensive income items that are excluded from net income. The Company's comprehensive income consists of unrealized gains (losses) on available for sale securities, net of income taxes and reclassification adjustments for gains and losses included in net income.

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------------------|
| | 2005 | 2004 |
| Net Income (Loss) | \$ 51,000 | \$ 103,000 |
| Other Comprehensive Gain (Loss): | | |
| Change in unrealized value of investments, net of income taxes | 496,000 | (1,528,000) |
| Less: | | |
| Reclassification adjustment for gains included in net income | (77,000) | (232,000) |
| Total comprehensive income (loss) | \$ 470,000 | \$ (1,657,000) |

Note 8. Segment Information

The Company has three reportable operating segments based on the nature of its product lines: Production Monitoring, Character Recognition, and Investments. The Controls Division manufactures and markets a complete line of production monitoring equipment, in particular speed monitoring and motor control systems for industrial machinery. ADS designs and markets a desktop software-based character recognition system that reads hand printed characters, checkmarks, and bar code information from scanned or faxed forms. Sales of this system include software and can include hardware. INV holds investments in marketable and non-marketable securities.

The accounting policies of the segments are the same as those described in Note 1. 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:

| | Three Months Ended March 31, | |
|--|---------------------------------|---------------------|
| | 2005 | 2004 |
| Net sales | | |
| Production monitoring | \$ 1,075,000 | \$ 1,007,000 |
| Character recognition | 129,000 | 209,000 |
| Investments | 0 | 0 |
| Total | \$ 1,204,000 | \$ 1,216,000 |
| Income (loss) before income taxes | | |
| Production monitoring | \$ 84,000 | \$ 76,000 |
| Character recognition | (37,000) | (14,000) |
| Investments | 31,000 | 154,000 |
| Total | \$ 78,000 | \$ 216,000 |

Certain expenses related to the conduct of our investment activities are included in general and administrative expenses in the accompanying consolidated statements of operations, but have been allocated to net income (loss) from our Investments segment in the above table.

Recent accounting standards:

In December 2004, FASB issued SFAS No. 123R which requires companies to recognize in the income statement the grant-date fair value of stock options and other equity-based compensation issued to employees, but expressed no preference for the type of valuation model. FASB No. 123R is effective for small business issuers as of the beginning of interim or annual reporting periods that begin after December 15, 2005. The impact of SFAS NO. 123R has not been determined at this time.

In November 2004, FASB issued SFAS No. 151 Inventory Costs which amends the guidance in ARB No. 43, Chapter 4 Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB 43, Chapter 4, previously stated that under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and

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rehandling costs may be so abnormal as to require treatment as current period charges. SFAS No. 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal. In addition, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 shall be effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after the date SFAS No. 151 was issued. SFAS No. 151 shall be applied prospectively. The Company does not expect the adoption of SFAS No. 151 to have a material effect on its consolidated financial statements.

Item 2. Management's Discussion and Analysis or Plan of Operation

RESULTS OF OPERATIONS

Net Sales

Total net sales for the three month period ended March 31, 2005 decreased \$12,000 or 1.0% when compared to net sales for the same period in 2004.

For the three months ended March 31, 2005 compared to the same period in 2004, the Controls Division contributed an increase in net sales \$68,000 or 6.8%. ADS experienced a decrease in net sales of \$80,000 or 38.3% for the three months ended March 31, 2005 compared to the same period in 2004.

The Controls Division has experienced an increase in sales for the first quarter of 2005 due in part to the recovery in the US economy and increased capital spending by our installed customer base. The bulk of our sales volume continues to be derived from the Speed Monitoring product lines to the grain and feed markets, as well as other key industrial markets. We are continuing to develop additional channel partners in the form of distributors and independent representatives, with the goal of finding customers and additional product applications.

In the first 3 months of 2004, there were several multi-license sales of software and scanners in ADS. This type of sale did not reoccur in the first quarter of 2005.

Cost of Goods Sold

The Company's cost of goods sold decreased \$21,000 or 4.5% for the three months ended March 31, 2005 compared to the same period in 2004. This decrease is primarily a direct result of decreased sales, but also reflects the Company's continuing efforts to manage costs and create efficiencies.

Gross Profit

Gross margins for the three month period ended March 31, 2005 were 63.0% versus 61.7% for the same period in 2004. This increase in margin is due primarily to the Company's continuing efforts to effectively manage and reduce production costs in both divisions.

Operating Expenses

Total operating expenses increased \$34,000 or 4.2% for the three months ended March 31, 2005 when compared to the same period of the prior year. Of this increase, the Controls Division contributed \$81,000 or 14.5%, offset by a decrease in ADS of \$21,000 or 9.5%, and INV contributed a decrease of \$26,000 or 100%.

Selling and marketing costs decreased \$6,000 or 2.2% for the three months ended March 31, 2005 when compared to the same period in 2004. Of the decrease for the three months ended March 31, 2005, the Controls Division contributed an increase of \$27,000 or 12.3%, which was offset by a decrease from ADS of \$33,000 or 34.7%. Marketing communications development for product launches, new literature, and ad development are the predominant expenses in the increase for the Controls Division. The decrease in ADS is primarily due to less personnel.

General and administrative costs increased \$8,000 or 2.5% for the three months ended March 31, 2005 compared to the same period in 2004. Of this increase, the Controls Division contributed an increase of \$34,000 or 13.2%, offset by a decrease in INV of \$26,000 or 100%. The overall increase in general and administrative costs from the Controls Division was due to a few key expenses, mainly general liability insurance, and some personnel costs.

Research and development costs increased \$33,000 or 19.3% for the three months ended March 31, 2005 compared to the same period in 2004. Of the increase, the Controls Division contributed \$21,000 or 25.9%, and ADS contributed an increase of \$12,000 or 13.3%. The increase in the Controls Division was due to increased costs of product development and product testing. The increase in ADS was due to increased personnel costs associated with software development.

Non-Operating Income (Loss)

Non-operating income decreased by \$113,000 for the three-month period ended March 31, 2005 compared to the same period for 2004.

Gain on the sale of investment securities decreased \$189,000 for the three month period ended March 31, 2005, compared to the same period in 2004. This decrease is a direct result of a lower volume of August Technology stock sold. For the three month period ended March 31, 2005, 11,950 shares of August Technology stock were sold with an average sale price of \$11.46 per share, compared to the same period in 2004 in which 15,000 shares of August Technology stock were sold with an average sale price of \$22.19 per share.

Interest income increased \$21,000 or 190.9% when comparing the three months ended March 31, 2005 to the same period in 2004. This increase was due to the higher interest rates on treasury bills.

Equity in losses of equity method investee decreased \$54,000 or 83.1% for the three months ended March 31, 2005 when compared to the same period in 2004. Please refer to Note 6 to the Company's interim financial statements included in this report for more information.

Income (Loss) Before Income Taxes

Income before income taxes decreased \$138,000 to an income before tax of \$78,000 for the three-month period ended March 31, 2005 compared to the same period in 2004.

The Controls Division had income before income taxes of \$84,000 for the three months ended March 31, 2005 compared to \$76,000 for the same period in 2004, an increase of \$8,000. In addition to the increased sales for the Controls Division, our overall efforts to reduce operating expenses contributed to the increase in net income before income taxes.

ADS had net loss before income taxes of \$37,000 for the three months ended March 31, 2005 compared to the net loss before income taxes of \$14,000 for same period in 2004. This decrease in net income before income tax is due to decreased sales in this division.

Investment income from investment securities decreased \$123,000 to an income before income taxes of \$31,000 for the three months ended March 31, 2005 compared to the same period in 2004. This decrease is primarily due to lowered August Technology stock sales when comparing the three months ended March 31, 2005 to the same period in 2004.

LIQUIDITY AND CAPITAL RESOURCES

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Cash and cash equivalents were \$6,516,000 at March 31, 2005 and \$6,464,000 at March 31, 2004. Cash provided by operating activities of \$56,000 for the three months ended March 31, 2005 is primarily a result of our net operating loss adjusted for non-cash charges.

Cash provided by investing activities was \$114,000 for the three month period ended March 31, 2005 and \$333,000 for the same period in 2004. Proceeds from the sale of investments for the three months ended March 31, 2005 decreased to \$136,000 from \$449,000 when compared to the same period in 2004.

Cash used in financing activities was \$118,000 and \$97,000 for the three months ended March 31, 2005 and March 31, 2004, respectively. During the three months ended March 31, 2005 and 2004, the Company paid aggregate dividends of \$128,000 and \$127,000, respectively.

Our ongoing cash requirements will be primarily for capital expenditures, acquisitions, research and development 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.

INV's primary investments are 657,765 shares of August Technology Corporation and 2,207,036 shares of PPT Vision, Inc. both of which are listed on a Nasdaq stock market. The investment in PPTV is accounted for under the equity method of accounting. These stocks are subject to fluctuations in price and could have a negative effect on the liquidity of the Company.

FORWARD-LOOKING STATEMENTS

This Form 10-QSB 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 the Company's expectations, beliefs, intentions or strategies regarding the future. Forward-looking statements include, but are not limited to, statements regarding the extent and timing of future revenues and expenses and customer demand, the market value of our investment securities, future financial condition and availability of capital resources, changes in worldwide general economic conditions, cyclical capital spending by customers, the Company's ability to keep pace with technological developments and evolving industry standards, worldwide competition, and the Company's ability to protect its existing intellectual property from challenges from third parties and other factors. 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 the Company as of the date hereof, and the Company assumes no obligation to update any such forward-looking statements. It is important to note that the Company's actual results could differ materially from those in such forward-looking statements. The forward-looking statements of the Company are subject to risks and uncertainties. Some of the factors that could cause future results to differ materially from the Company's recent results or those projected in the forward-looking statements are detailed in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2004, filed with the Securities and Exchange Commission.

Item 3. Controls and Procedures.

As of the end of the period covered by this report, the Company conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of 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 (the Exchange Act)). Based on this evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

There was no change in the Company's internal control over financial reporting during the Company's most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 6. Exhibits

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

SIGNATURES

In accordance with 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.

May 16, 2005

/s/ Bradley D. Slye
Bradley D. Slye
Chief Executive Officer and Principal Accounting Officer

EXHIBIT INDEX

ELECTRO-SENSORS, INC.

FORM 10-QSB FOR QUARTER ENDED March 31, 2005

| 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 |