

ELECTRO SENSORS INC
Form 10-Q
May 09, 2013

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 March 31, 2013

**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 **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 May 8, 2013 was 3,393,736.

ELECTRO-SENSORS, INC.

Form 10-Q

For the Quarter Ended March 31, 2013

TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited):

<u>Condensed Consolidated Balance Sheets – As of March 31, 2013 and December 31, 2012</u>	3
<u>Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) – For the Three months ended March 31, 2013 and March 31, 2012</u>	4
<u>Condensed Consolidated Statements of Cash Flows – For the Three months ended March 31, 2013 and March 31, 2012</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6

<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	11
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	13
<u>Item 4. Controls and Procedures</u>	13

PART II – OTHER INFORMATION

<u>Item 1. Legal Proceedings</u>	14
<u>Item 1A. Risk Factors</u>	14
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	14
<u>Item 3. Defaults Upon Senior Securities</u>	14
<u>Item 4. Mine Safety Disclosures</u>	14
<u>Item 5. Other Information</u>	14
<u>Item 6. Exhibits</u>	14

<u>SIGNATURES</u>	15
--------------------------	----

<u>EXHIBITS</u>	16
------------------------	----

PART I. FINANCIAL INFORMATION**Item 1. Financial Statements****ELECTRO-SENSORS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands except share and per share amounts)

	March 31, 2013	December 31, 2012
ASSETS		
Current assets		
Cash and cash equivalents	\$ 825	\$ 1,102
Treasury Bills	5,250	5,248
Available-for-sale securities	3,135	3,677
Trade receivables, less allowance for doubtful accounts of \$8 and \$10, respectively	702	602
Inventories	1,323	1,330
Other current assets	136	75
Total current assets	11,371	12,034
Property and equipment, net	1,288	1,304
Total assets	\$ 12,659	\$ 13,338
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 122	\$ 94
Accrued expenses	274	227
Accrued income tax	24	313
Total current liabilities	420	634
Deferred income tax liability	1,289	1,455
Commitments and contingencies		

Stockholders' equity

Common stock par value \$0.10 per share; authorized 10,000,000 shares; issued and outstanding: 3,393,736 and 3,391,912 shares, respectively	339	339
Additional paid-in capital	1,581	1,575
Retained earnings	7,143	7,113
Accumulated other comprehensive income (unrealized gain on available-for-sale securities, net of income tax)	1,887	2,222
Total stockholders' equity	10,950	11,249
Total liabilities and stockholders' equity	\$ 12,659	\$ 13,338

See accompanying notes to condensed consolidated financial statements

Table of Contents**ELECTRO-SENSORS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)**

(in thousands except share and per share amounts)

(unaudited)

	Three Months Ended March 31,	
	2013	2012
Net sales	\$1,534	\$1,642
Cost of goods sold	642	706
Gross profit	892	936
Operating expenses:		
Selling and marketing	395	410
General and administrative	298	277
Research and development	118	127
Total operating expenses	811	814
Operating income	81	122
Non-operating income:		
Gain on sale of available-for-sale securities	103	0
Interest income	2	1
Other income	3	3
Total non-operating income	108	4
Income before income taxes	189	126
Income taxes	23	48
Net income	\$166	\$78
Other comprehensive income (loss):		
Change in unrealized value of available-for-sale securities, net of income tax	\$(232)) \$393
Reclassification of gains included in net income	(103)) 0
Net change in other comprehensive income (loss)	(335)) 393
Total comprehensive income (loss)	\$(169)) \$471
Net income per share data:		

Basic

Net income per share	\$0.04	\$0.02
Weighted average shares	3,393,655	3,390,719

Diluted

Net income per share	\$0.04	\$0.02
Weighted average shares	3,415,635	3,407,699

Dividends paid per common share	\$0.04	\$0.04
--	---------------	--------

See accompanying notes to condensed consolidated financial statements

Table of Contents**ELECTRO-SENSORS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

	Three Months Ended March 31, 2013 2012	
Cash flows from (used in) operating activities		
Net income	\$166	\$78
Adjustments to reconcile net income to net cash from (used in) operating activities:		
Depreciation	27	16
Gain on sale of available-for-sale securities	(103)	0
Deferred income taxes	40	3
Interest accrued on investments	(2)	0
Change in allowance for doubtful accounts	(2)	8
Change in:		
Trade receivables	(98)	24
Inventories	7	5
Other current assets	(61)	(19)
Accounts payable	28	64
Accrued expenses	47	43
Accrued income taxes	(289)	35
Net cash from (used in) operating activities	(240)	257
Cash flows from (used in) investing activities		
Proceeds from sale of available-for-sale securities	104	0
Purchase of property and equipment	(11)	(21)
Net cash from (used in) investing activities	93	(21)
Cash flows from (used in) financing activities		
Proceeds from issuance of common stock	6	4
Dividends paid	(136)	(135)
Net cash used in financing activities	(130)	(131)
Net increase (decrease) in cash and cash equivalents	(277)	105

Edgar Filing: ELECTRO SENSORS INC - Form 10-Q

Cash and cash equivalents, beginning	1,102	5,476
Cash and cash equivalents, ending	\$825	\$5,581

Supplemental schedule of non-cash investing and financing activities

Net change in unrealized gain (loss) on investments	\$(335)	\$393
---	-----------------	-------

Supplemental cash flow information

Cash paid for income taxes	\$272	\$11
----------------------------	--------------	------

See accompanying notes to condensed consolidated financial statements

Table of Contents

ELECTRO-SENSORS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE PERIOD ENDED MARCH 31, 2013

(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, 2012, 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 as of March 31, 2013 and for the three-month period 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

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. manufactures and markets a complete line of speed monitoring and motor control systems for industrial machinery. The Company utilizes leading-edge technology to continuously improve its products and make them easier to use with the ultimate goal of manufacturing 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 who use the products to monitor process machinery operations. The Company markets its products to a number of different industries located throughout the United States, Asia, Central America, Canada, and Europe.

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 the Company, through ESI Investment Company, invests in other businesses or companies, the Company does not intend to become an investment company and intends to remain primarily an operating company. The Company's primary investment is 265,767 shares of Rudolph Technologies, Inc. which is accounted for using the available-for-sale method. See Note 4 for additional information regarding the Company's investments. The Company's investments in securities are subject to normal market risks.

Revenue recognition

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. The Company's 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

Available for Sale Securities

ESI Investment Company's portfolio consists of equity securities, primarily common stocks, money market funds, commercial paper, and government debt securities. The estimated fair value of publicly traded equity securities 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. 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, are included 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, for substantially the full term of the asset or liability.
- 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 cash equivalents, treasury bills, commercial paper, money market funds, investments, trade receivables, accounts payable, and other working capital items approximate fair value at March 31, 2013 and December 31, 2012 due to the short maturity nature of these instruments.

Income taxes

Deferred income taxes are presented as assets or liabilities based on timing differences between financial reporting and tax reporting methods. 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 tax assets are reduced by a valuation allowance to the extent that realization of the related deferred tax asset is not assured.

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 assets/liabilities, inventory and investments. It is at least reasonably possible that these estimates may change in the near term.

Table of Contents**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 March 31, 2013, the Company had one stock-based employee compensation plan. During the three-month periods ended March 31, 2013 and 2012, there were no stock options granted or exercised.

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. Investments

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

	Cost	Gross unrealized gain	Gross unrealized loss	Fair value
March 31, 2013				
Money Market	\$ 632,000	\$ 0	\$ 0	\$ 632,000
Commercial Paper	75,000	0	0	75,000
Treasury Bills	5,249,000	1,000	0	5,250,000
Equity Securities	91,000	3,098,000	(54,000)	3,135,000
	6,047,000	3,099,000	(54,000)	9,092,000
Less Cash Equivalents	707,000	0	0	707,000
Total Investments, March 31, 2013	\$ 5,340,000	\$ 3,099,000	\$ (54,000)	\$ 8,385,000
December 31, 2012				
Money Market	\$ 804,000	\$ 0	\$ 0	\$ 804,000
Commercial Paper	200,000	0	0	200,000
Treasury Bills	5,249,000	0	(1,000)	5,248,000

Edgar Filing: ELECTRO SENSORS INC - Form 10-Q

Equity Securities	92,000	3,639,000	(54,000)	3,677,000
	6,345,000	3,639,000	(55,000)	9,929,000
Less Cash Equivalents	1,004,000	0	0	1,004,000
Total Investments, December 31, 2012	\$ 5,341,000	\$ 3,639,000	\$ (55,000)	\$ 8,925,000

At March 31, 2013 and December 31, 2012, the Company's significant investment in equity securities was 265,767 and 273,267 shares, respectively, of Rudolph Technologies, Inc. ("Rudolph"), which is accounted for under the available-for-sale method. As of March 31, 2013 and December 31, 2012, the aggregate value of the Company's Rudolph shares as reported on the Nasdaq Stock Market was approximately \$3,131,000 and \$3,673,000, respectively, with an approximate cost of \$35,000 and \$36,000, respectively. During the quarter ended March 31, 2013, the Company sold 7,500 shares of Rudolph stock and reported a gain of \$103,000 in non-operating income.

Table of Contents

Note 5. 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 March 31, 2013	Fair Value March 31, 2013	Fair Value Measurement Using		
			Level 1	Level 2	Level 3

Assets:

Cash and cash equivalents