ELECTRO SENSORS INC
Form 10KSB/A
October 24, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-KSB/A

Amendment No. 2

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2004

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

For the transition period from __________ to __________

Commission File Number 0-9587

ELECTRO-SENSORS, INC.

(Name of Small Business Issuer in its Charter)

Minnesota	**41-0943459**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification Number)

6111 Blue Circle Drive
Minnetonka, Minnesota 55343-9108
(Address of Principal Executive Offices, including Zip Code)

(952) 930-0100
(Registrant s Telephone Number, including Area Code)

Securities registered pursuant to Section 12(b) of the Act: **None**
Securities registered pursuant to Section 12(g) of the Act: **Common Stock, $0.10 par value**

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 x   No o

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. o

The issuer s revenues for the fiscal year ended December 31, 2004 were $4,799,000.

The aggregate market value of the voting stock held by non-affiliates (persons other than officers, directors, or holders of more than 5% of the outstanding stock) of the registrant was approximately $8,157,000 based upon the closing price of the Common Stock as reported on The Nasdaq Stock Market® on February 21, 2005.

The number of shares outstanding of the registrant s Common Stock, $0.10 par value, on February 21, 2005 was 3,219,212.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for its Annual Meeting of Shareholders are incorporated by reference into Part III of this Form 10-KSB.

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

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ELECTRO-SENSORS, INC. AND SUBSIDIARIES
Form 10-KSB/A for the Year Ended December 31, 2004

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Explanatory Note

This Amendment No. 2 to Form 10-KSB is being filed solely to correct a typographical error affecting the date for one of the fiscal years covered by one of the reports issued by the company s independent registered public accounting firm with respect to the company s audited financial statements.

Item 7 Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Electro-Sensors, Inc.
Minneapolis, Minnesota

We have audited the accompanying consolidated balance sheet of Electro-Sensors, Inc. and Subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in stockholders equity, and cash flows for the years ended December 31, 2004 and 2003. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Electro-Sensors, Inc. and Subsidiaries as of December 31, 2004, and 2003, and the results of their operations and their cash flows for the years ended December 31, 2004, and 2003 in conformity with accounting principles generally accepted in the United States of America.

VIRCHOW, KRAUSE & COMPANY, LLP

Minneapolis, Minnesota
January 28, 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Electro-Sensors, Inc.
Minneapolis, Minnesota

We have audited Electro-Sensors, Inc. and Subsidiaries statements of income, changes in stockholders equity, and cash flows for the period ended December 31, 2002. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Electro-Sensors, Inc. and Subsidiaries, the results of their operations and their cash flows for the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

MAYER HOFFMAN MCCANN P.C. (formerly known as SCHWEITZER, KARON & BREMER, LLC)
Certified Public Accountants
Minneapolis, Minnesota
March 14, 2005

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ELECTRO-SENSORS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 6,464,000	$ 6,863,000
Available for sale securities	7,334,000	13,416,000
Trade receivables, less allowance for doubtful accounts, 2004: $6,000 and 2003: $6,000	559,000	515,000
Inventories	810,000	758,000
Other current assets	68,000	62,000
Prepaid income taxes	127,000	0
Total current assets	15,362,000	21,614,000
PROPERTY AND EQUIPMENT, net	1,402,000	1,470,000
INVESTMENT IN EQUITY METHOD INVESTEE	140,000	152,000
TOTAL ASSETS	$ 16,904,000	$ 23,236,000
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 162,000	$ 106,000
Accrued expenses	248,000	263,000
Accrued income taxes	0	96,000
Deferred income tax	2,623,000	4,795,000
Deferred revenue	68,000	48,000
Total current liabilities	3,101,000	5,308,000
DEFERRED INCOME TAXES	0	26,000
COMMITMENTS AND CONTINGENCIES (Notes 6 and 8)		

	December 31,	
STOCKHOLDERS EQUITY		
Common stock, par value $0.10 per share; authorized 10,000,000 shares; issued 3,218,345 and 3,174,522 shares, respectively	322,000	317,000
Additional paid-in capital	1,104,000	1,000,000
Retained earnings	7,964,000	8,305,000
Accumulated other comprehensive income	4,413,000	8,280,000
Total stockholders equity	13,803,000	17,902,000
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 16,904,000	$ 23,236,000

See Notes to Consolidated Financial Statements

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

	Years Ended December 31,		
	2004	**2003**	**2002**
Net Sales	$ 4,799,000	$ 4,358,000	$ 4,478,000
Cost of Goods Sold	1,821,000	1,700,000	1,858,000
Gross Profit	2,978,000	2,658,000	2,620,000
Operating Expenses:			
Selling and Marketing	1,251,000	1,212,000	1,138,000
General and Administrative	1,026,000	1,031,000	983,000
Research and Development	762,000	772,000	1,090,000
Total Operating Expenses	3,039,000	3,015,000	3,211,000
Operating Loss	(61,000)	(357,000)	(591,000)
Non-operating Income (Expense):			
Gain on Sale of Investment Securities	441,000	1,205,000	2,261,000
Interest Income	86,000	62,000	223,000
Equity in losses of equity method investee	(172,000)	(734,000)	(607,000)

	Years Ended December 31,		
Total Non-operating Income (Expense)	355,000	533,000	1,877,000
Income (Loss) Before Income Taxes	294,000	176,000	1,286,000
Federal and State Income Taxes	122,000	320,000	641,000
Net Income (Loss)	$ 172,000	$ (144,000)	$ 645,000
Net Income (Loss) Per Share Data:			
Basic			
Net Income (Loss) Per Share	$ 0.05	$ (0.05)	$ 0.21
Weighted Average Shares	3,206,176	3,166,098	3,145,244
Diluted			
Net Income (Loss) Per Share	$ 0.05	$ (0.05)	$ 0.20
Weighted Average Shares	3,316,196	3,166,098	3,246,122
Dividends Paid Per Common Share	$ 0.16	$ 0.13	$ 0.12

See Notes to Consolidated Financial Statements

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ELECTRO-SENSORS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY

	Common Stock Issued		Additional Paid-in Capital	Retained Earnings	Comprehensive Income/(loss)	Accumulated Other Comprehensive Income	Total Stockholders Equity
	Shares	Amount					
Balance, December 31, 2001	3,121,263	$ 311,000	$ 895,000	$ 8,592,000		$ 6,965,000	$ 16,763,000
Exercise of stock options	33,350	3,000	70,000				73,000
Unrealized gains (losses) on investments net of reclassification adjustment					(4,437,000)	(4,437,000)	(4,437,000)
Stock issued through the employee stock purchase plan	647	1,000	2,000				3,000
Dividend on common stock				(378,000)			(378,000)
Net income				646,000	646,000		646,000
Total comprehensive loss					(3,791,000)		
Balance, December 31, 2002	3,155,260	315,000	967,000	8,860,000		2,528,000	12,670,000

						Accumulated	
Exercise of stock options	15,750	1,000	25,000				26,000
Unrealized gains (losses) on investments net of reclassification adjustment					5,753,000	5,753,000	5,753,000
Stock issued through the employee stock purchase plan	3,512	1,000	8,000				9,000
Dividend on common stock				(411,000)			(411,000)
Net loss				(144,000)	(144,000)		(144,000)
Total comprehensive income					5,609,000		
Balance, December 31, 2003	3,174,522	317,000	1,000,000	8,305,000		8,280,000	17,902,000
Exercise of stock options	40,750	4,000	95,000				99,000
Unrealized gains (losses) on investments net of reclassification adjustment					(3,867,000)	(3,867,000)	(3,867,000)
Stock issued through the employee stock purchase plan	3,073	1,000	9,000				10,000
Dividend on common stock				(513,000)			(513,000)
Net income				172,000	172,000		172,000
Total comprehensive loss					$ (3,695,000)		
Balance, December 31, 2004	3,218,345	$ 322,000	$ 1,104,000	$ 7,964,000		$ 4,413,000	$ 13,803,000

See Notes to Consolidated Financial Statements

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

	Years Ended December 31, 2004	2003	2002
Cash flows from operating activities			
Net income (loss)	$ 172,000	$ (144,000)	$ 645,000
Adjustments to reconcile net income (loss) to net cash used in operating activities:			
Depreciation	83,000	98,000	98,000
Realized (gain)/loss on sale of investments	(441,000)	(1,205,000)	(2,261,000)
Deferred taxes		(9,000)	14,000
Equity in loss of equity method investee	172,000	734,000	607,000
(Increase)/decrease in:			
Trade receivables	(44,000)	35,000	(52,000)

	Years Ended December 31,		
Inventory	(52,000)	(20,000)	81,000
Other current assets	(6,000)	8,000	141,000
Prepaid income taxes	(127,000)	358,000	(343,000)
Increase/(decrease) in:			
Accounts payable	56,000	(179,000)	220,000
Accrued expenses	(15,000)	51,000	72,000
Deferred revenue	20,000	(2,000)	50,000
Accrued income taxes	(96,000)	0	1,647,000
Net cash used in operating activities	(278,000)	(275,000)	(2,375,000)
Cash flows from investing activities:			
Proceeds from sale of available for sale securities	788,000	1,407,000	2,281,000
Purchase of equity securities	(326,000)	(591,000)	(1,109,000)
Payment for purchase of investments	(160,000)	0	0
Purchase of property and equipment	(19,000)	(25,000)	(161,000)
Net cash provided by investing activities	283,000	791,000	1,011,000
Cash flows from financing activities:			
Proceeds from issuance of stock	109,000	35,000	76,000
Dividends paid	(513,000)	(411,000)	(378,000)
Net cash used in financing activities	(404,000)	(376,000)	(302,000)
Net increase/(decrease) in cash & cash equivalents	(399,000)	140,000	(1,666,000)
Cash & cash equivalents, beginning	6,863,000	6,723,000	8,390,000
Cash & cash equivalents, ending	$ 6,464,000	$ 6,863,000	$ 6,723,000
Supplemental schedule of non-cash investing and financing activities			
Net change in unrealized gain/(loss) on investments	$ 6,065,000	$ 9,204,518	$ 6,919,000

See Notes to Consolidated Financial Statements

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ELECTRO-SENSORS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Nature of Business and Significant Accounting Policies

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. 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 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. Since then, the Company has recognized income from the sale of its holdings in August Technology Corporation. See Note 2 for additional information regarding its investments. The Company s investments in marketable securities are subject to normal market risks.

Significant accounting policies of the Company are summarized below:

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.

Cash and cash equivalents:

The Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents are carried at cost plus accrued interest which approximates fair value.

The Company maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses on such accounts. The Company believes it is not exposed to any significant credit risk on cash.

Receivables and Credit Policies:

Accounts receivable are uncollateralized customer obligations due under normal trade terms requiring payment within 30 days from the invoice date. Accounts receivables are stated at the amount billed to the customer. Customer account balances with invoices over 90 days are considered delinquent. The Company does not accrue interest on delinquent accounts receivable.

Payments of accounts receivable are allocated to the specific invoices identified on the customer s remittance advice or, if unspecified, are applied to the earliest unpaid invoices.

The carrying amount of accounts receivable is reduced by a valuation allowance that reflects management s best estimate of the amounts that will not be collected. Management individually reviews all accounts receivable balances that exceed 90 days from the invoice date and based on an assessment of current creditworthiness, estimates the portion, if any, of the balance that will not be collected. Management uses this information to estimate the valuation allowance.

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Available for sale securities:

The Company s investments consist of marketable equity securities, primarily common stocks, government debt securities, money market funds, and unregistered equity securities. The estimated fair value of marketable 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 does not buy and sell investments with the objective of generating profits on short-term fluctuations in market price, the investments in marketable equity securities have been classified as available-for-sale. Available-for-sale securities 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. Dividends on marketable equity securities are recognized in income when declared. Investments in unregistered securities are reported at original cost.

Realized gains and losses, including losses from declines in value of specific securities determined by management to be other-than-temporary, are included in income. Realized gains and losses are determined on the basis of the specific securities sold.

Inventories:

Inventories include material, labor and overhead and are valued at the lower of cost (first-in, first-out) or market.

Fair value of financial instruments:

The Company s financial instruments consist of cash and cash equivalents, investments, short-term trade receivables and payables for which current carrying amounts approximate fair market value.

Property and equipment:

Property and equipment are recorded at cost. Expenditures for renewals and betterments are capitalized and repairs and maintenance costs are charged to expense as incurred. When items are disposed of, the cost and accumulated depreciation are eliminated from the accounts, and any gain or loss is reflected in the results of operations.

Impairment of long-lived assets:

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted future net cash flows expected to be generated by the assets. If these assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

Software costs:

The Company capitalizes software production costs after technological feasibility has been established and prior to general release to clients. Annual amortization of capitalized software will be based on the greater amount computed using the straight-line method over the estimated 36-month economic product life or using the ratio that current gross revenue for the software product bears to the total of current and anticipated future gross revenues for that product. The capitalized software production costs of the Company s existing technology were fully amortized prior to 2002. Software maintenance and modification costs are expensed as incurred.

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.

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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 moved to income over the life of the contract.

Advertising costs:

The Company expenses advertising costs as incurred. Total advertising expense was $184,000, $109,000 and $233,000 for the years ended December 31, 2004, 2003 and 2002, respectively.

Research and development:

Expenditures for research and development are expensed as incurred.

Depreciation:

The cost of property and equipment is depreciated on the straight-line method over the estimated useful lives.

Estimated useful lives are as follows:

	Years
Equipment	3-10
Furniture and Fixtures	3-10
Building	7-40

Depreciation expense for the years ended December 31, 2004, 2003 and 2002 was $83,000, $98,000, and $98,000, respectively.

Income taxes:

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

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Net income (loss) per common share:

EPS excludes dilution and is determined by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that could occur if securities and other contracts to issue common stock were exercised or converted into common stock.

The following information presents the Company s computations of basic and diluted EPS for the periods presented in the statements of operations.

	Income/(loss)	Shares	Per Share Amount
2004:			
Basic EPS	$ 172,000	3,206,176	$ 0.05
Effect of dilutive employee stock options		110,020	
Diluted EPS	$ 172,000	3,316,196	$ 0.05
2003:			
Basic EPS	$ (144,000)	3,166,098	$ (0.05)
Effect of dilutive employee stock options		0	
Diluted EPS	$ (144,000)	3,166,098	$ (0.05)
2002:			
Basic EPS	$ 645,000	3,145,244	$ 0.21
Effect of dilutive employee stock options		100,878	0.01
Diluted EPS	$ 645,000	3,246,122	$ 0.20

For the years ended December 31, 2004, 2003 and 2002, options to purchase 319,500, 259,250, and 60,000 shares, respectively, of the Company s common stock were not included in the calculation of diluted earnings per share. As the Company had a net loss for 2003, the inclusion of the aforementioned shares would have been anti-dilutive for 2003.

Comprehensive income (loss):

Comprehensive income includes the Company s net income (loss) plus other comprehensive income (loss) items, which 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 adjustment for gains and losses included in net income (loss). The reclassification adjustment for gains and losses included in net income (loss) was $304,000, $753,000 and $1,420,000, for 2004, 2003 and 2002, respectively. The Company does not have any additional transactions or other economic events that qualify as comprehensive income as defined under SFAS No. 130. Income taxes expense (benefit) included in other comprehensive income was ($2,193,000), $3,452,000, and $1,446,000 for 2004, 2003, and 2002 respectively.

Stock 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.

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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:

	Years Ended December 31,		
	2004	**2003**	**2002**
Net Income (Loss)			
As Reported	$ 172,000	$ (144,000)	$ 645,000
Pro Forma	94,000	(172,000)	605,000
Net Income (Loss) Per Common Share			
As Reported	$ 0.05	$ (0.05)	$ 0.21
Pro Forma	$ 0.03	$ (0.05)	$ 0.19
Stock Based Compensation			
As Reported	$ 0	$ 0	$ 0
Pro Forma	$ 78,000	$ 28,000	$ 40,000

The weighted average fair values of options and Employee Stock Plan shares granted were as follows. There were no grants in fiscal 2003:

	1987 and 1997 Plan	
	Employees	**Directors**
2002 Grants	$ 1.14	$ 1.84
2003 Grants	N/A	N/A
2004 Grants	$ 2.67	N/A

The fair value of options granted were estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants in fiscal 2004 (there were no grants in fiscal 2003):

	2004	**2003**
Risk-free Interest Rate	3.00%	N/A
Expected Life of Options	10 years	N/A
Expected Volatility	52.19%	N/A
Expected Dividend Yield	0.00%	N/A

The tax benefits associated with the exercise of stock options or issuance of shares under the Company s stock option plans, not related to expenses recognized for financial reporting purposes, have been credited to capital in excess of par value in the accompanying consolidated balance sheets.

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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 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.

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Note 2. Investments

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

	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
December 31, 2004				
Treasury Bills	$ 6,365,000	$ 0	$ 0	$ 6,365,000
Money Market Funds	14,000	0	0	14,000
Equity Securities	217,000	7,225,000	(108,000)	7,334,000
	6,596,000	7,225,000	(108,000)	13,713,000
Less Cash Equivalents	(6,379,000)	0	0	(6,379,000)
Total Investments	$ 217,000	$ 7,225,000	$ (108,000)	$ 7,334,000
December 31, 2003				
Treasury Bills	$ 6,472,000	$ 0	$ 0	$ 6,472,000
Money Market Funds	133,000	0	0	133,000
Equity Securities	238,000	13,285,000	(107,000)	13,416,000
	6,843,000	13,285,000	(107,000)	20,021,000
Less Cash Equivalents	(6,605,000)	0	0	(6,605,000)

	Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Total Investments	$ 238,000	$ 13,285,000	$ (107,000)	$ 13,416,000
December 31, 2002				
Treasury Bills	$ 6,344,000	$ 0	$ 0	$ 6,344,000
Money Market Funds	77,000	0	0	77,000
Equity Securities	229,000	4,081,000	(108,000)	4,202,000
	6,650,000	4,081,000	(108,000)	10,623,000
Less Cash Equivalents	(6,421,000)	0	0	(6,421,000)
Total Investments	$ 229,000	$ 4,081,000	$ (108,000)	$ 4,202,000

Realized gains and losses on investments are as follows:

	2004	December 31, 2003	2002
Gross Realized Gains	$ 441,000	$ 1,205,000	$ 2,261,000
Gross Realized Losses	0	0	0
Net Realized Gain	$ 441,000	$ 1,205,000	$ 2,261,000

The Company s significant investment in equity securities is 669,715 shares of August Technology Corporation whose shares are traded on the Nasdaq Stock Exchange with a December 31, 2004 market value of approximately $7,052,000 with an approximate cost of $67,000.

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Investment Reported on Equity Method:

At December 31, 2004, the Company owned 2,207,036 shares of PPT, which is 18.4% of PPT s outstanding common stock. The fair value of its holdings based on the quoted market price at December 31, 2004 was approximately $2,163,000 with an approximate cost of $2,434,000.

Since the Company owns approximately 18.4% 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 through December 31, 2004 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 December 31, 2004, the Company had approximately $698,000 in suspended losses from its investment in PPT that will be used to offset future recognition of equity method earnings from the investment.

Summary financial information of PPT Vision, Inc. as of October 31, 2004 and 2003 is as follows:

Balance Sheet	2004	2003

	2004	2003
Current assets	$ 5,949,000	$ 5,269,000
Fixed assets	323,000	582,000
Intangible and other assets	162,000	205,000
Assets of discontinued operations	0	2,391,000
Total assets	$ 6,434,000	$ 8,447,000
Current liabilities	$ 1,511,000	$ 1,767,000
Stockholder equity	4,923,000	6,680,000
Total liabilities and equity	$ 6,434,000	$ 8,447,000

Income statement, years ended October 31	**2004**	**2003**
Net revenues	$ 8,671,000	$ 7,501,000
Gross profit	4,517,000	4,082,000
Total expenses	5,572,000	6,692,000
Net loss from continuing operations	(1,055,000)	(2,610,000)
Net loss from discontinued operations	(817,000)	(1,513,000)
Net loss	$ (1,872,000)	$ (4,123,000)

In April 2004, ESI Investment 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 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.

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Note 3. Inventories

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

	December 31, 2004	December 31, 2003
Raw Materials	$ 560,000	$ 553,000
Work In Process	106,000	90,000
Finished Goods	144,000	115,000
Total Inventories	$ 810,000	$ 758,000

Note 4. Property and Equipment

The following is a summary of property and equipment:

	December 31, 2004		December 31, 2003	
Equipment	$	345,000	$	339,000
Furniture and Fixtures		551,000		533,000
Building		1,341,000		1,341,000
Land		415,000		415,000
		2,652,000		2,628,000
Less Accumulated Depreciation		1,250,000		1,158,000
Total Property and Equipment	$	1,402,000	$	1,470,000

Note 5. Accrued Expenses

Accrued expenses include the following:

	2004		2003	
Wages and Commissions	$	245,000	$	233,000
Other		3,000		30,000
Total Accrued Expenses	$	248,000	$	263,000

Note 6. Commitments

Lease commitments:

The Company is leasing office equipment under operating leases expiring at various dates through 2008.

Minimum lease payments required under non-cancelable operating leases are as follows:

Year	Amount	
2005	$	**12,000**
2006		**10,000**
2007		**10,000**
2008		**10,000**
Total Minimum Lease Payments	$	**42,000**

Rental expense charged to operations was $35,000, $31,000 and $26,000 for years ended December 31, 2004, 2003 and 2002, respectively.

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Note 7. Common Stock Options and Stock Purchase Plan

Stock-based compensation:

The Company has a stock option plan and an employee stock purchase and bonus plan. Under the 1997 Stock Option Plan, the Company is authorized to grant up to 450,000 shares of its common stock. The Company granted 101,000 options under this plan during 2004, and at December 31, 2004, 15,250 shares remained available for grant under this plan. Under the Employee Stock Purchase and Bonus Plan, the Company is authorized to sell and issue up to 150,000 shares of its common stock to its full-time employees. During 2004, 2003 and 2002, 3,073, 3,512 and 647 shares, respectively, were issued under this plan. At December 31, 2004, 92,740 shares were available for future issuance.

Stock options:

The 1997 Stock Option Plan includes both nonqualified and incentive stock options. Payment for the shares may be made in cash, shares of the Company s common stock or a combination thereof. Under the terms of the plan, incentive stock options are granted at 100% of fair market value on the date of grant and may be exercised at various times depending upon the terms of the option. The nonqualified stock options were granted to directors to purchase shares of the Company s common stock. All existing options expire 10 years from the date of grant or one year from the date of death.

A summary of stock options outstanding and exercisable under the plans are as follows:

	Number of Shares			
	Incentive Options		Director Options	
	Stock Options	Weighted Avg. Exercise Price	Stock Options	Weighted Avg Exercise Price
Balance, December 31, 2001	237,050	2.23	87,000	2.69
Granted	10,000	3.14	9,000	4.49
Exercised	(21,600)	1.68	(11,750)	3.17
Expired	0	0.00	(1,750)	3.17
Forfeited	0	0.00	0	0.00
Balance, December 31, 2002	225,450	2.33	82,500	2.81
Granted	0	0.00	0	0.00
Exercised	(15,750)	1.68	0	0.00
Expired	0	0.00	(13,500)	3.17
Forfeited	(19,450)	2.90	0	0.00
Balance, December 31, 2003	190,250	2.33	69,000	2.74
Granted	101,000	4.16	0	0.00
Exercised	(20,500)	2.22	(20,250)	2.67
Expired	0	0.00	0	0.00
Forfeited	0	0.00	0	0.00
Balance, December 31, 2004	**270,750**	**$ 3.02**	**48,750**	**$ 2.77**
Options Exercisable At December 31, 2004	**201,590**	**$ 2.64**	**48,750**	**$ 2.77**

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Price range of outstanding options:

	As of December 31, 2004	
	Incentive Options	**Directors Options**
Price Range	$1.33 to $4.16	$2.00 to $4.49
Expiration Dates	2007 to 2014	2005 to 2012

The following table summarizes stock options outstanding at December 31, 2004:

Exercise Price Range	**Outstanding Options**	**Exercisable Options**	**Weighted Avg. Contractual Life Remaining**	**Weighted Avg. Exercise Price**
$1.33 - $1.99	30,000	30,000	4.87	$1.49
$2.00 - $2.99	158,500	158,500	4.41	$2.37
$3.00 - $4.49	131,000	61,840	7.17	$3.97

Stock purchase plan:

The Employee Stock Purchase and Bonus Plan (the Employee Stock Plan) allows employees to set aside up to 10% of their earnings for the purchase of shares of the Company s common stock. The purchase price is the lower of 85% of the market value at the date of the grant or the exercise date, which is six months from the date of the grant.

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Note 8. Benefit Plans

Employee stock ownership plan:

The Company sponsors an employee stock ownership plan (ESOP) that covers substantially all employees who work 1,000 or more hours during the year. The ESOP has, at various times, secured financing from the Company to purchase the Company s shares on the open market. When the Plan purchases shares with the proceeds of the Company loans, the shares are pledged as collateral for its debt. The shares are maintained in a suspense account until released and allocated to participant accounts. The Plan owns 136,088 shares of the Company s stock at December 31, 2004. All shares held by the Plan have been released and allocated. The dividends paid by the Company on shares held by the Plan are allocated to the participant accounts. The Plan had no debt to the Company at December 31, 2004.

ESOP compensation expense was $18,000, $18,000, and $18,000, for the years ended December 31, 2004, 2003, and 2002, respectively.

In the event a terminated ESOP participant desires to sell his or her shares of the Company s stock and the shares are not readily tradable, the Company may be required to purchase the shares from the participant at their fair market value. At December 31, 2004, 136,088 shares of the Company s stock, with an aggregate fair market value of approximately $554,000, are held by ESOP participants who, if terminated, would be subject to the repurchase requirement.

Profit sharing plan and savings plan:

The Company has a salary reduction and profit sharing plan which conforms to IRS provisions for 401(k) plans. The Company may make profit sharing contributions with the approval of the Board of Directors. The Board of Directors decided to make no contribution for the years 2004, 2003 and 2002 other than its matching of 401(k) salary reductions.

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Note 9. Income Taxes

The components of the income tax provision for the years ended December 31, 2004, 2003, and 2002 are as follows:

	2004	2003	2002
Current:			
Federal	$ 99,000	$ 292,700	$ 580,500
State	18,000	36,300	46,500
Deferred:			
Federal	5,000	(9,000)	12,600
State	0	0	1,100
Total Federal and State Income Taxes	$ 122,000	$ 320,000	$ 640,700

The provision for income taxes for the years ended December 31, 2003, 2002, and 2001 differs from the amount obtained by applying the U.S. federal income tax rate to pretax income due to the following:

	2004	2003	2002
Computed Expected Tax Expense	$ 100,000	$ 52,000	$ 438,000
Increase (Decrease) in Taxes Resulting From:			
State Income Taxes, net of Federal Benefit	18,000	24,000	29,000
Credits	(20,000)	(20,000)	(36,000)
Other	(36,000)	14,000	19,000
Tax on losses of equity method investee	60,000	250,000	192,000
Total Federal and State Income Taxes	$ 122,000	$ 320,000	$ 642,000

	2004	2003	2002

The components of the net deferred tax asset (liability) consist of:

	2004	2003
Deferred Tax Assets:		
Vacation Disallowance	$ 2,000	$ 24,000
Depreciation	14,000	0
Allowance for Doubtful Accounts	20,000	2,000
Investment in Equity Method Investee	927,000	867,000
Valuation Allowance	(927,000)	(867,000)
Total Deferred Tax Assets	$ 36,000	$ 26,000
Deferred Tax Liabilities:		
Depreciation	$ 0	$ (26,000)
Net Unrealized Gain on Investments	2,659,000	(4,821,000)
Total Deferred Tax Liabilities	$ (2,623,000)	$ (4,847,000)
Net Deferred Tax Asset (Liability)	$ (2,623,000)	$ (4,821,000)

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Note 10. Segment Information

The Company has three reportable operating segments based on the nature of its product lines: Production Monitoring, Character Recognition, and Investments. The Production Monitoring Division manufactures and markets a complete line of speed monitoring and motor control systems for industrial machinery. The Character Recognition Division designs and markets a desktop software-based 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. The Investments Division 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:

	2004	2003	2002
Net Revenues			
Production Monitoring	**$** 4,045,000	$ 3,758,000	$ 3,719,000
Character Recognition	754,000	600,000	759,000
Investments	0	0	0
Total	4,799,000	4,358,000	4,478,000
Sales in Foreign Countries			
Production Monitoring	311,000	234,000	250,000

	2004	2003	2002
Character Recognition	18,000	38,000	45,000
Investments	0	0	0
Total	329,000	272,000	295,000
Interest Income			
Production Monitoring	20,000	24,000	101,000
Character Recognition	0	0	0
Investments	66,000	38,000	122,000
Total	86,000	62,000	223,000
Depreciation Expense			
Production Monitoring	81,000	94,000	79,000
Character Recognition	2,000	4,000	19,000
Investments	0	0	0
Total	83,000	98,000	98,000
Capital Purchases			
Production Monitoring	19,000	25,000	161,000
Character Recognition	0	0	0
Investments	0	0	0
Total	19,000	25,000	161,000
Total Assets			
Production Monitoring	5,119,000	5,269,000	5,063,000
Character Recognition	5,000	5,000	5,000
Investments	11,780,000	17,962,000	9,604,000
Total	16,904,000	23,236,000	14,672,000
Income (Loss) Before Income Taxes			
Production Monitoring	447,000	181,000	(184,000)
Character Recognition	(32,000)	(82,000)	(167,000)
Investments	(121,000)	77,000	1,637,000
Total	294,000	176,000	1,286,000

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PART III

Item 13 Exhibits

See Exhibit Index on the page following the signatures.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

By: /s/ BRADLEY D. SLYE

Bradley D. Slye
President and Chief Executive Officer

Date: October 24, 2005

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SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

EXHIBIT INDEX TO FORM 10-KSB

For the Fiscal Year Ended
December 31, 2004

Commission File No. 0-9587

Exhibit Number	Exhibit Description
31.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.