ELECTRO SENSORS INC
Form 10-Q
August 10, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

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

For the quarterly period ended June 30, 2012

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

For the transition period from ______ to ______

Commission File Number 0-9587

ELECTRO-SENSORS, INC.

(Exact name of registrant as specified in its charter)

Minnesota	41-0943459
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6111 Blue Circle Drive
Minnetonka, Minnesota 55343-9108

(Address of principal executive offices)

(952) 930-0100

(Registrant's telephone number, including area code)

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

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

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

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

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

The number of shares outstanding of the registrant's common stock, $0.10 par value, on August 9, 2012 was 3,391,912.

ELECTRO-SENSORS, INC.

Form 10-Q

For the Period Ended June 30, 2012

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ELECTRO-SENSORS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

(in thousands except share and per share amounts)

ASSETS	June 30, 2012 (unaudited)	December 31, 2011
Current assets		
Cash and cash equivalents.	$ 5,634	$ 5,476
Available for sale securities	2,996	3,181
Trade receivables, less allowance for doubtful accounts of $8 and $9, respectively.	794	731
Inventories	1,221	1,228
Income tax receivable	0	17
Other current assets	99	116
Total current assets.	10,744	10,749
Property and equipment, net.	1,189	1,179
Total assets	$ 11,933	$ 11,928
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 189	$ 110
Accrued expenses.	290	214
Accrued income tax.	41	0
Total current liabilities	520	324
Deferred income tax liability	1,154	1,225
Commitments and contingencies		

Stockholders' equity		
Common stock par value $0.10 per share; authorized 10,000,000 shares; issued and outstanding: 3,390,785 and 3,389,577 shares, respectively	339	339
Additional paid-in capital.	1,565	1,561
Retained earnings	6,561	6,570
Accumulated other comprehensive income (unrealized gain on available for sale securities, net of income tax)	1,794	1,909
Total stockholders' equity	10,259	10,379
Total liabilities and stockholders' equity.	$ 11,933	$ 11,928

See accompanying notes to unaudited condensed consolidated financial statements

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ELECTRO-SENSORS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(in thousands except share and per share amounts)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net sales	$1,795	$1,543	$3,437	$3,060
Cost of goods sold	787	658	1,493	1,283
Gross profit	1,008	885	1,944	1,777
Operating expenses:				
Selling and marketing	383	349	793	695
General and administrative	248	226	525	479
Research and development	101	118	228	219
Total operating expenses	732	693	1,546	1,393
Operating income	276	192	398	384
Non-operating income:				
Interest income	3	1	4	4
Gain on investment securities	0	1	0	1
Other income	3	1	6	3
Total non-operating income	6	3	10	8
Income from continuing operations before income taxes	282	195	408	392
Income taxes	99	78	147	147
Income before discontinued operations	183	117	261	245
Income (loss) from discontinued operations, net of income taxes	0	1	0	(33)
Net income	$183	$118	$261	$212
Other comprehensive income (loss):				
Change in unrealized value of investments, net of income tax	$(508)	$(80)	$(115)	$561
Total comprehensive income (loss)	$(325)	$38	$146	$773
Net income (loss) per share data:				
Basic				

Net income per share continuing operations	$0.05	$0.03	$0.07	$0.07
Net loss per share discontinued operations	0.00	0.00	0.00	(0.01)
Net income per share	0.05	0.03	0.07	0.06
Weighted average shares	3,390,785	3,388,241	3,390,752	3,386,016
Diluted				
Net income per share continuing operations	$0.05	$0.03	$0.07	$0.07
Net loss per share discontinued operations	0.00	0.00	0.00	(0.01)
Net income per share	0.05	0.03	0.07	0.06
Weighted average shares	3,407,765	3,405,468	3,407,732	3,405,358
Dividends paid per share	$.04	$.04	$.08	$.08

See accompanying notes to unaudited condensed consolidated financial statements

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ELECTRO-SENSORS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six Months Ended June 30, 2012	2011
Cash flows from (used in) operating activities		
Net income	$261	$212
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation	32	28
Deferred income taxes	(1)	(7)
Change in allowance for doubtful accounts	(1)	0
Interest accrued on investments	0	(3)
Change in:		
Trade receivables	(62)	(232)
Inventories	7	(155)
Other current assets	17	(2)
Accounts payable	79	96
Accrued expenses	76	133
Deferred revenue	0	(5)
Accrued income taxes	58	105
Net cash from operating activities	466	170
Cash flows from (used in) investing activities		
Purchase of treasury bills	0	(4,300)
Proceeds from the maturity of treasury bills	0	4,300
Purchase of property and equipment	(42)	(9)
Net cash used in investing activities	(42)	(9)
Cash flows from (used in) financing activities		
Proceeds from issuance of stock	4	18
Dividends paid	(270)	(272)
Net cash used in financing activities	(266)	(254)

Net increase (decrease) in cash and cash equivalents	158	(93)
Cash and cash equivalents, beginning	5,476	583
Cash and cash equivalents, ending	$5,634	$490
Supplemental schedule of non-cash investing and financing activities		
Net change in unrealized gain (loss) on investments	$(115)	$561
Supplemental cash flow information		
Cash paid for income taxes	$109	$52

See accompanying notes to unaudited condensed consolidated financial statements

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ELECTRO-SENSORS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE PERIOD ENDED JUNE 30, 2012

(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, 2011, 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 June 30, 2012 and for the three and six month periods then ended. 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 343,267 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.

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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, investments, trade receivables, accounts payable, and other working capital items approximate fair value at June 30, 2012 and December 31, 2011 due to the short maturity nature of these items.

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

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Reclassifications

Certain items related to discontinued operations in the 2011 financial statements have been reclassified. These reclassifications had no effect on stockholders' equity, net income or cash flows.

Subsequent Events

On July 18, 2012, the Company declared a $.04 dividend on its common stock, payable on August 17, 2012 to shareholders of record as of August 3, 2012.

On July 18, 2012, the Company granted each of its four non-employee directors ten-year options to purchase 2,500 shares of the Company's common stock at an exercise price of $4.15 per share. The options were fully-vested and immediately exercisable as of the grant date.

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 June 30, 2012, the Company had one stock-based employee compensation plan. During the six months ended June 30, 2011, two employees exercised options to purchase a total of 4,500 shares of common stock. There were no options exercised during the six months ended June 30, 2012. There were no options granted in the six months ended June 30, 2012 or 2011.

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
June 30, 2012				
Commercial Paper	5,447,000	0	0	5,447,000
Equity Securities	101,000	2,949,000	(54,000)	2,996,000
	5,548,000	2,949,000	(54,000)	8,443,000
Less Cash and Cash Equivalents	5,447,000	0	0	5,447,000
Total Investments, June 30, 2012	$101,000	$2,949,000	$ (54,000)	$2,996,000
December 31, 2011				
Commercial Paper	5,373,000	0	0	5,373,000
Equity Securities	101,000	3,134,000	(54,000)	3,181,000
	5,474,000	3,134,000	(54,000)	8,554,000
Less Cash and Cash Equivalents	5,373,000	0	0	5,373,000
Total Investments, December 31, 2011	$101,000	$3,134,000	$ (54,000)	$3,181,000

At June 30, 2012 and December 31, 2011, the Company's significant investment in equity securities was 343,267 shares of Rudolph Technologies, Inc. ("Rudolph"), which is accounted for under the available-for-sale method. As of June 30, 2012 and December 31, 2011, the aggregate value of the Company's Rudolph shares as reported on the Nasdaq Stock Exchange was approximately $2,993,000 and $3,134,000, respectively, with an approximate cost of $45,000.

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Note 5. Fair Value Measurements

The following table provides information on the Company's investment assets measured at fair value on a recurring basis.

	Carrying amount in condensed consolidated balance sheet June 30, 2012	Fair Value June 30, 2012	Fair Value Measurement Using		
			Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents:					
Commercial Paper	$ 5,447,000	$5,447,000	$5,447,000	$ 0	$ 0
Available-for-sale:					
Equity Securities	$ 2,996,000	$2,996, 000	$2,996,000	$ 0	$ 0

	Carrying amount in condensed consolidated Balance Sheet December 31, 2011	Fair Value December 31, 2011	Fair Value Measurement Using		
			Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents:					
Commercial Paper	$ 5,373,000	$5,373,000	$5,373,000	$ 0	$ 0
Available-for-sale:					
Equity Securities	$ 3,181,000	$3,181,000	$3,181,000	$ 0	$ 0

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

Note 6. Inventories

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

	June 30, 2012	December 31, 2011
Raw Materials	**$796,000**	$791,000
Work In Process	**223,000**	247,000
Finished Goods	**202,000**	190,000
Total Inventories	**$1,221,000**	$1,228,000

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Note 7. Discontinued Operations

On September 16, 2011, the Company sold its entire interest in its AutoData Systems Division to Auto Data Inc. (ADI). The purchase price will be paid as an earn-out based on three percent of the software, hardware, and maintenance contracts that ADI sells over the next five years (four percent while ADI continues to occupy our building). As of June 30, 2012, ADI owed the Company approximately $10,000 under the earn-out. The amount is included in other current assets on the balance sheet.

The division, a separate operating segment as described in Note 8, designed and marketed desktop software based systems that read hand printed characters, checkmarks and bar code information from scanned or faxed forms, in addition to collecting and reporting data from web forms.

The financial results of the discontinued operation are as follows:

	For the three months ended June 30, 2011	For the six months ended June 30, 2011
Net sales	$124,000	$194,000
Expenses	(123,000)	(234,000)
Net income (loss) before income taxes	1,000	(40,000)
Income tax benefit	0	7,000
Net income (loss) of discontinued operations	$1,000	$(33,000)

The effect of the discontinued operation on the financial position of the Company, as of December 31, 2011, is as follows:

Property and equipment	$2,000
Inventories	17,000
Accounts receivable	35,000
Net assets disposed	$54,000

Accrued expenses	$10,000
Deferred revenue	58,000
Net liabilities disposed	$68,000
Net cash paid to ADI	$14,000

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Note 8. Segment Information

Prior to September 16, 2011, the Company had three reportable operating segments based on the nature of its product lines: Production Monitoring, AutoData Systems, and Investments. The AutoData Systems segment was sold on September 16, 2011 as described in Note 7. The operations of that segment are presented as discontinued operations in the accompanying financial statements and are excluded from the presentation of segment information from continuing operations in this note. The reclassification of AutoData Systems to discontinued operations had no impact on the results of operations presented for the Production Monitoring or Investments segments.

As of June 30, 2012, The Company has two reportable operating segments: Production Monitoring and Investments. The Production Monitoring Division manufactures and markets a complete line of production monitoring equipment, in particular speed monitoring and motor control systems for industrial machinery. ESI Investment Company holds investments in marketable and non-marketable securities.

The accounting policies of the segments are the same as those described in Note 1 of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. In evaluating segment performance, management focuses on sales and income before taxes. The Company has no inter-segment sales.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
External sales				
Production monitoring	**$1,795**	$1,543	**$3,437**	$3,060
Investments	**0**	0	**0**	0
Total	**$1,795**	$1,543	**$3,437**	$3,060
Net income before taxes				
Production monitoring	**$281**	$193	**$406**	$388
Investments	**1**	2	**2**	4
Total	**$282**	$195	**$408**	$392

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

CRITICAL ACCOUNTING ESTIMATES

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make decisions based upon estimates, assumptions, and factors it considers relevant to the circumstances. Such decisions include the selection of applicable accounting principles and the use of judgment in their application, the results of which impact reported amounts and disclosures. Changes in economic conditions or other business circumstances may affect the outcomes of management's estimates and assumptions. An in-depth description of our accounting estimates can be found in the interim financial statements included in this report and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. No new estimates exist other than those discussed in our Annual Report.

RESULTS OF OPERATIONS

Net Sales

Net sales for the three-month period ended June 30, 2012 increased $252,000, or 16.3%, when compared to the same period in 2011. Net sales for the six-month period ended June 30, 2012 increased $377,000, or 12.3%, when compared to the same period in 2011. The increase in sales was spread across our product lines in several industries. Sales efforts contributing to increased net sales included participating in regional and national tradeshows and continued direct sales calls in order to develop close relationships with new and existing customers. Our customers' plant and machinery automation projects continued to increase in scope, resulting in increased demand for the products in our sensor product line and contributing to increased net sales.

Cost of Goods Sold

Our cost of goods sold increased $129,000, or 19.6%, for the three months ended June 30, 2012 compared to the same period in 2011. For the six-month period ended June 30, 2012, the cost of goods sold increased $210,000, or 16.4%, compared to the same period in 2011. The increases were primarily a direct result of increased sales. We continue our efforts to maintain or reduce production costs by manufacturing products in the most cost effective manner.

Gross Profit

Gross margin for the three-month period ended June 30, 2012 was 56.2% versus 57.4% for the same period in 2011. For the six-month periods ended June 30, 2012 and 2011, gross margins were 56.6% and 58.1%, respectively. The decrease in gross margin was due to increased cost of raw materials.

Operating Expenses

Total operating expenses increased $39,000, or 5.6%, for the three months ended June 30, 2012 when compared to the same period in 2011. Total operating expenses increased $153,000, or 11.0%, for the six months ended June 30, 2012 when compared to the same period in 2011.

Selling and marketing costs increased $34,000, or 9.7%, for the three months ended June 30, 2012 when compared to the same period in 2011. For the six months ended June 30, 2012, selling and marketing costs increased $98,000, or 14.1%, when compared to the same period in 2011. For the three months ended June 30, 2012, the increase was due to higher wages and bonuses due to additional sales personnel and increased sales and commission expense to outside manufacturer's representatives, offset by a decrease in advertising and marketing resulting from a change in the mix of direct advertising and tradeshows. For the six months ended June 30, 2012, the increase was due to higher wages and bonuses, commission expense, increased travel and tradeshows and sales demonstration equipment, offset by a decrease in advertising and marketing expenses due to reallocation of advertising expenses in direct marketing efforts.

General and administrative costs increased $22,000, or 9.7%, for the three months ended June 30, 2012 compared to the same period in 2011. For the six months ended June 30, 2012, general and administrative costs increased $46,000, or 9.6%, when compared to the same period in 2011. For the three months ended June 30, 2012, the increase was due to increased public reporting fees (these fees were expensed during the second quarter of 2012 as opposed to the first quarter of 2011) and expanded XBRL reporting requirements. For the six months ended June 30, 2012, the increase was due to the allocation of expenses to the Production Monitoring division during 2012 that had been allocated to the AutoData Systems division in 2011, increased public reporting fees (including expenses associated with expanded XBRL reporting requirements), bad debt expense, and building maintenance expenses.

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Research and development costs decreased $17,000, or 14.4%, for the three months ended June 30, 2012 compared to the same period in 2011. For the six months ended June 30, 2012, research and development costs increased $9,000, or 4.1%, when compared to the same period in 2011. For the three months ended June 30, 2012, the decrease was due to a decrease in salaries and wages and contract engineering (due to development and installation of the Electro-Sentry system during 2011). For the six months ended June 30, 2012, the increase resulted from an increase in lab testing fees for product testing and approval for hazardous location and legal expenses related to patent applications.

Non-Operating Income

Non-operating income increased by $3,000, or 100.0%, for the three-month period ended June 30, 2012 compared to the same period for 2011. For the six months ended June 30, 2012, non-operating income increased $2,000, or 25.0%, when compared to the same period in 2011. The increases for the three and six months ended June 30, 2012 were mainly due to the amounts recognized under the earn-out for the sale of the AutoData division to Auto Data, Inc.

Interest income increased $2,000, or 200.0%, when comparing the three months ended June 30, 2012 to the same period in 2011 due to the timing of interest recognized on Treasury Bills owned in 2011. For the six months ended June 30, 2012, interest income was unchanged when compared to the same period in 2011.

Income From Continuing Operations Before Income Taxes

Income from continuing operations before income taxes was $282,000 for the three months ended June 30, 2012, representing an increase of $87,000, or 44.6%, when compared to the same period in 2011. Income from continuing operations before income taxes was $408,000 for the six months ended June 30, 2012, representing an increase of $16,000, or 4.1%, when compared to the same period in 2011.

The Production Monitoring Division had income before income taxes of $281,000 for the three months ended June 30, 2012 compared to $193,000 for the same period in 2011, an increase of $88,000, or 45.6%. For the six months ended June 30, 2012, the Production Monitoring Division had income before income taxes of $406,000 compared to $388,000 for the same period in 2011, an increase of $18,000, or 4.6%. These increases in income before income taxes were mainly due to increased sales.

ESI Investment Company had income before taxes of $1,000 for the three-month period ended June 30, 2012 compared to $2,000 for the same period in 2011 a decrease of $1,000, or 50.0%. ESI Investment Company had income before taxes of $2,000 for the six-month period ended June 30, 2012 compared to $4,000 for the same period in 2011, a decrease of $2,000, or 50.0%. These decreases were mainly due to that fact that, during the three months ended June 30, 2011, one of ESI Investment Company's investments merged and, due to the merger, we received $1,500 and shares in the merged company. We reported $1,000 as a gain on the sale of the investment in 2011. As of June 30, 2012, ESI Investment Company had approximately $2,948,000 in unrealized gain on the Rudolph Technologies, Inc. investment that is reported in Other Comprehensive Income (See Note 4 "Investments" in the notes to the accompanying condensed consolidated financial statements).

Loss From Discontinued Operations

On September 16, 2011, we sold our entire interest in our AutoData Systems Division to Auto Data Inc. (ADI). The purchase price will be paid as an earn-out based on three percent of the software, hardware, and maintenance contracts that ADI sells over the next five years (four percent while ADI continues to occupy our building). The transaction was intended to allow us to focus on our core markets.

For the three-month period ended June 30, 2011, the AutoData Systems Division had an operating income, net of income taxes, of $1,000. For the six-month period ended June 30, 2011, the AutoData Systems Division had an operating loss, net of income taxes, of $33,000. There was no activity related to the discontinued operations during the three or six months ended June 30, 2012.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were $5,634,000 at June 30, 2012, $5,476,000 at December 31, 2011, and $490,000 at June 30, 2011.

Cash provided by operating activities was $466,000 and $170,000 for the six months ended June 30, 2012 and 2011, respectively, an increase of $296,000. The increase was primarily due to a $170,000 net change in trade receivables and a $162,000 net change in inventories. The net change in trade receivables was due to an increase in the balance of $62,000 at June 30, 2012 compared to the prior year increase in the balance of $232,000 at June 30, 2011. The increase in accounts receivable was due to increased sales. The net change in inventories was due to a decrease in the balance of $7,000 at June 30, 2012 compared to the prior year increase in the balance of $155,000 at June 30, 2011. The decrease in inventory was due to increased sales.

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Cash used in investing activities was $42,000 and $9,000 for the six-month periods ended June 30, 2012 and 2011, respectively. The increase in cash used by investing activities was due to increased purchases of equipment. During the six-month period ended June 30, 2011, the Company purchased $4,300,000 in Treasury Bills and had $4,300,000 in Treasury Bills mature.

Cash used in financing activities was $266,000 and $254,000 for the six months ended June 30, 2012 and 2011, respectively. During the six-month periods ended June 30, 2012 and 2011, we paid aggregate dividends of $270,000 and $272,000, respectively. During the six-month periods ended June 30, 2012 and 2011, we had $4,000 and $7,000, respectively, in stock purchases under the Employee Stock Purchase Plan for each year. During the six-month period ended June 30, 2011, we had two employees exercise stock options in the amount of $11,000. There were no options exercised during 2012.

Our ongoing cash requirements will be primarily for capital expenditures, 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.

Our primary investment is 343,267 shares of Rudolph Technologies, Inc., listed on the Nasdaq stock market, accounted for using the available-for-sale method. The investment is subject to fluctuations in market price and could have a negative effect on our liquidity.

Off-balance Sheet Arrangements

As of June 30, 2012, the Company had no off-balance sheet arrangements or transactions.

FORWARD-LOOKING STATEMENTS

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

All forward-looking statements in this document are based on information available to us as of the date hereof, and we assume no obligation to update any such forward-looking statements, other than as required by law. It is important to note that our actual results could differ materially from those in such forward-looking statements. The forward-looking statements we make in this Quarterly Report are subject to certain risks and uncertainties that could cause future results to differ materially from our recent results or those projected in the forward-looking statements, including the accuracy of management's assumptions with respect to industry trends, fluctuations in industry conditions, the accuracy of management's assumptions regarding expenses and our cash needs and those listed under the heading "Cautionary Statements" under "Item 1—Business," in our Annual Report on Form 10-K for the year ended December 31, 2011.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not Applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company's management, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act") were effective as of June 30, 2012 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the second quarter of 2012, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings - None.

Item 1A. Risk Factors - Not Applicable.

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

Item 3. Defaults Upon Senior Securities - None.

Item 4. Mine Safety Disclosures – Not Applicable.

Item 5. Other Information - None.

Item 6. Exhibits

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

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SIGNATURES

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

Electro-Sensors, Inc.

August 10, 2012 /s/ Bradley D. Slye
Bradley D. Slye
Chief Executive Officer and Chief Financial Officer

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EXHIBIT INDEX

ELECTRO-SENSORS, INC.

FORM 10-Q FOR QUARTER ENDED JUNE 30, 2012

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
101	The following financial information from Electro-Sensors, Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2012, formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Balance Sheet as of June 30, 2012 and December 31, 2011, (ii) Condensed Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 30, 2012 and June 30, 2011, (iii) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and June 30, 2011, and (iv) Notes to Condensed Consolidated Financial Statements.*

*Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.

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