ELECTRO SENSORS INC
Form 10-K
March 09, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-K

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

For the fiscal year ended December 31, 2009

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

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, including zip code)

(952) 930-0100
(Registrant s telephone number)

Securities registered under Section 12(b) of the Exchange Act:
Common Stock, $0.10 par value, registered on the NASDAQ (Capital) Market
Securities registered under Section 12(g) of the Exchange Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes o No x

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

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 o No o

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K is not contained herein, and will not 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-K or any amendment to this Form 10-K. x

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

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

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 $5,400,000 based upon the closing price of the Common Stock as reported on The Nasdaq Stock Market® on March 4, 2010.

The number of shares outstanding of the registrant s Common Stock, $0.10 par value, on March 4, 2010 was 3,380,290.

DOCUMENTS INCORPORATED BY REFERENCE

Certain information called for by Part III of this Form 10-K is incorporated by reference from the registrant s Definitive Proxy Statement which will be filed pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered by this report.

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PART I

Item 1. Business.

Introduction

Electro-Sensors, Inc. (we , us , our , the Company or ESI) is engaged in two distinct operating segments: (1) the manufacture and distribution industrial production monitoring and process control systems through our Production Monitoring Division, and (2) the development and distribution of PC-based software for both automated survey processing and hand printed character recognition through our AutoData Systems Division. The operating segments are based on the markets that we serve and the products that we provide to those markets.

In addition, through our subsidiary ESI Investment Company, we periodically make strategic investments in other businesses and companies, primarily when we believe that such investments will facilitate development of technology complementary to our existing products. Although we invest in other businesses and companies through our subsidiary ESI Investment Company, we do not intend to become an investment company and intend to remain primarily an operating company. Our primary investments are 343,267 shares of Rudolph Technologies, Inc. and 551,759 shares of PPT Vision, Inc. The Rudolph Technologies, Inc. investment is accounted for using the available-for-sale method. The PPT Vision investment is accounted for under the equity method of accounting.

Unless indicated otherwise, the terms Company and ESI when used herein, includes Electro-Sensors, Inc. and its consolidated subsidiaries. As of December 31, 2009, ESI had two consolidated subsidiaries: ESI Investment Company and Senstar Corporation. Senstar Corporation does not have any business operations.

ESI, incorporated in Minnesota in July 1968, has executive offices located at 6111 Blue Circle Drive, Minnetonka, Minnesota, 55343 and telephone number (952) 930-0100.

Operating Segments/Principal Products/Markets
We have three reportable operating segments based on the nature of our product lines: Production Monitoring, AutoData Systems Division, and Investments. Detailed financial results and segment information are provided below in Part II, Item 8, *Financial Statements and Supplementary Data Notes to Consolidated Financial Statements, Note 11, Segment Information*.

<u>*Production Monitoring Division*</u>

Our Production Monitoring Division manufactures and sells several different types of monitoring systems that measure actual machine production and operation rates, as well as systems that regulate the speed of related machines in production processes.

Speed Monitoring Systems. Our original products, speed monitoring systems, compare machine revolutions per minute or speed against acceptable rates as determined by the customer. The monitors generally have the same relative operating principle and use a non-contacting sensing head that translates the speed of a rotating shaft into analog readouts. The systems include a signal-generating pulser disc or wrap that attaches to a rotating shaft, the sensing device, and a control unit. The systems vary in complexity, from a simple system that detects slow-downs or stoppages, to more sophisticated systems that warn of deviations from precise tolerances and that permit various subsidiary operations to be determined through monitoring the shaft speed.

The speed monitoring systems include a line of digital products that translate sensor impulses from its production monitoring systems into digital readouts indicating production counts or rates, such as parts, gallons, or board feet. The speed monitoring systems also include alarm systems, tachometers, and other devices that translate impulses from the sensors into alarm signals, computer inputs, or digital displays that are usable by the customer.

Three production monitoring devices that do not operate by measuring shaft speeds are also in the speed monitoring systems product line. These devices are the tilt switch, vibration monitor, and slide gate position monitor. A tilt switch is designed to alert the operator when a storage bin or production system reaches a certain capacity (*e.g.,* when grain fills a silo). A vibration monitor will alert an operator when the vibration of a machine in a production system exceeds or is below a specified level. The slide gate position monitor is used in plant operations to provide feedback of the position of a slide gate. As part of our Electro-Sentry Hazard Monitoring system, we also have temperature sensors that are used to monitor bearing temperature and belt misalignment.

Drive Control Systems. In 1987, we expanded our speed monitoring systems product line to include products that regulate and synchronize machine speeds. Drive Control System products not only monitor machine operation levels, but also regulate the speed of motors on related machines in a production sequence to ensure that the performances of various operations are coordinated. In the past, these distinct features allowed us to market these products under the Drive Control Systems name. The product line consists of a line of digital control products for motors that require a complete closed loop PID (Proportional Integral Derivative) control. The closed loop controllers coordinate production speed among process motors and reduce waste.

In 1988, we entered into a sales agreement with Motrona GmbH (the West German manufacturer of a Synchronous Drive Controller (SDC) product line), giving us rights to distribute in the United States the drive control products manufactured by Motrona GmbH. The SDC product line manufactured by Motrona GmbH coordinates motors in a production machine with other parts of the machine process. The SDC products were designed as a precision speed reference for use with variable speed drives and to enable manufacturers to match speed/velocity and phase/position of independently driven machines so they operate together. Applications include synchronizing overhead and floor conveyors and load sharing of multiple motors.

We believe that manufacturing companies can achieve significant savings in both time and materials by adding drive control technology to existing manufacturing processes to coordinate operation of related machines. We intend to continue to market our products to this retro-fit market and also to companies building new manufacturing machinery or processing systems.

In 2008, we introduced our Electro-Sentry Hazard Monitoring System which integrates our sensors for bearing temperature, belt misalignment, and shaft speed with a programmable logic controller and touch screen interface to create a complete system for hazard monitoring. By doing this, we are enabling our customer to locate which part of the material handling system is operating incorrectly, typically in less than ten seconds. This is done by using visual diagrams on the touch screen.

We expect to continue to expend resources in development and marketing of our various Production Monitoring Systems throughout 2010.

AutoData Systems Division

AutoData became an operating segment in January 1993. We initially began development of the AutoData Systems Division (AutoData) as a development project chartered to create opportunities using proprietary pattern recognition technology. The current outcome of the project is two Microsoft® Windows®-based software programs that automate the collection of data from surveys and other forms. AutoData software reads hand-printed characters, checkmarks, and barcodes from images of scanned forms or from forms filled out online.

By automatically extracting information from paper forms and converting it into a format compatible with most computer databases, AutoData offers an alternative to manual data entry. This intelligent data entry alternative saves time, strain, and money compared to the manual method of data entry. The basis of the handprint reading capability is Associative Pattern Memory (APM), a patented pattern recognition algorithm. APM is a trainable, neural network-based memory that was incorporated in a Dynamic Link Library (DLL) and is used in the products currently sold by AutoData. The APM patent is owned by PPT Vision and AutoData has been granted an exclusive open-ended license to use the patent.

AutoData released AutoData Scannable Office software in March 2000. Scannable Office was the product replacement for PRO and provided an upgrade path for PRO customers. Scannable Office offered a key enhancement: integration with the Microsoft Office Suite. Scannable Office allows the user to create scannable forms in Microsoft Word. The software reads data from images of completed forms and automatically places the extracted data directly into Microsoft® Excel, Access, or any ODBC-compliant database, setting data up for analysis. Scannable Office has the widest recognition capabilities of the AutoData end-user products; it contains hand print (ICR), optical character (OCR), optical mark (OMR) and barcode recognition engines, and image capture capability.

In December 2002, we released AutoData ExpertScan . ExpertScan has hand print (ICR), optical mark (OMR) and barcode recognition engines, and image capture capability. Like Survey Plus 2000, ExpertScan automates survey and form processing, as well as tabulation of results. The product offers several form design and reporting enhancements. It has also been sold as an upgrade to Survey Plus 2000, which was retired in January 2005. ExpertScan provides a mid-range option for prospective AutoData customers. The most recent software, NetE-nable , a web add-on to ExpertScan released in August 2007, completes the Company s AutoData product offerings. Prospective customers frequently call AutoData in search of a single software program that combines both paper and web data collection, while existing ExpertScan customers have expressed a desire for web functionality. ExpertScan with NetE-nable fulfills both of these needs, and provides a single database (paper and web data combined) from which ExpertScan creates reports and analysis.

NetE-nable offers a more convenient way for people to respond on a survey or form to what an organization needs to know, in ways the customer or respondent might not if provided with only paper forms.

A major advantage of this new product is that it allows data from both paper and electronic forms to be collected by the same software in one easy-to-use package. Another big advantage is that no additional hardware is needed. Online forms are stored on the NetE-nable server in a secure environment along with any data that is collected.

The NetE-nable Wizard permits the user to transform any survey or form already created in ExpertScan into an online form. It only takes about seven clicks of the mouse to complete the process of publishing a form or survey to the Web. In four clicks, NetE-nable retrieves the data from the online form into the Access database that ExpertScan built automatically when the form was originally designed. Paper and Web form data automatically populates the same Access database, and the ExpertScan reports generator analyzes that data and creates a variety of reports.

The typical customer for NetE-nable is any current ExpertScan customer, as well as any future customers of ExpertScan software, which is a prerequisite for purchasing NetE-nable.

ExpertScan with NetE-nable continues to be a successful addition to the AutoData product line.

Marketing and Distribution

Production Monitoring Division. The Production Monitoring Division sells its products primarily through home office sales people who deal directly with customers and a number of manufacturer s representatives and distributors located throughout the United States, Mexico, China, Canada, Peru, Chile, Bolivia, Colombia, Thailand, Israel, Malaysia, Singapore, Great Britain, and South Africa. The sensing and control units are sold under the Electro-Sensors, Inc. brand as a range of products from simple sensors to complex motor speed controllers. These products are sold to businesses in all major standard industrial classifications, including grain, feed, biofuels, food processing, chemicals, agricultural, mining, utility, forest products, steel, tire, glass and electronics. Any business that uses machinery with a rotating shaft is a potential customer.

We advertise in national industrial periodicals that cover a wide range of industrial products and attend several national and international tradeshows designated for the industry throughout the year. A corporate website and other related industry websites are also used for advertising and marketing purposes. We expect to continue to market our products in this and related markets.

AutoData Systems Division. The AutoData Systems Division markets its products primarily through home office sales personnel who deal directly with end-users and a limited number of Value-Added Resellers (VARs). This division primarily sells in the United States, Canada and Western Europe, and currently actively markets only in the U.S.

Competition

Production Monitoring Division. Competition for our monitoring products arises from a broad range of industrial and commercial businesses. Design, quality and multiplicity of application, rather than price, are the focus of competition in selling these products. We face substantial competition for our production monitoring systems. Many of these competitors are well established and larger than us in terms of total sales volume. Among our larger competitors are Danaher Controls, Red Lion Controls, Control Concepts, 4B Elevator Components Ltd., Durant Corporation, and Contrex, Inc. We believe our competitive advantages include that our products are sold as ready-to-install units and that our products have a wide range of applications. Our major disadvantages include the fact that our major competitors are much larger, have a broader variety of sensing instruments, and have larger sales forces and established names.

AutoData Systems Division. Competition for the market segment primarily ranges from substitute products such as Data Entry suppliers, to directly competitive software suppliers, and suppliers of web-based survey software and services. We believe that few direct competitors have as sophisticated recognition capabilities as our products. However, our products face direct competition from both ends of the spectrum: larger competitors offering a broader array of software products and services, and firms similar in size that offer a low-priced, more limited product.

The market is segmented based primarily on price and capabilities, with the larger firms, notably Cardiff Software and Captiva Software, offering enterprise-wide systems with broad information capture capabilities. Our products are focused on desktop, rather than enterprise-wide, solutions, positioning our products as most appropriate to small offices and departments of larger organizations.

Because price is a primary competitive factor, we are subject to increasing pressures to make price adjustments to remain competitive. Such downward price adjustments, if any, may have an adverse impact on our results of operations if not offset by an increase in revenues and/or a reduction in expenses.

Suppliers

Production Monitoring Division. The Production Monitoring Division purchases parts and materials for its production monitoring systems from various manufacturers and distributors. In some instances, these materials are manufactured in accordance with proprietary designs. Multiple sources of these supplies and materials are readily available, and the Production Monitoring Division is not dependent on any single source for these supplies and materials. This Division has not experienced any problem of short supply or delays from its suppliers.

AutoData Systems Division. The AutoData Systems Division purchases a variety of supplies and materials from various vendors and is not dependent upon any one source.

We purchase a variety of parts, components, and other supplies from a variety of vendors for both of our operating divisions. While we usually have more than a single source of supply for those various parts, components and supplies, it is possible occasionally that there will be only one supplier for any single part, component or supply. Should a supplier be unwilling or unable to supply such an item in a timely manner, our business could be materially adversely affected.

Customers

We are not dependent upon a single or a few customers for a material (10% or more) portion of our sales in any of our operating divisions.

Patents, Trademarks and Licenses

The names Electro-Sensors and AutoData are trademarks registered with the U.S. Patent and Trademark Office, respectively as Reg. No. 1,142,310 and Reg. No. 1,874,543. We believe our trademarks have been and will continue to be useful in developing and protecting market recognition for our products.

We hold four patents relating to our Production Monitoring Systems, and have obtained six patents related to our character recognition technology. We have also entered into an open-ended license agreement with Motrona GmbH, a manufacturer of a Synchronous Drive Controller (SDC) product line, which grants us rights to distribute in the United States the drive control products manufactured by Motrona GmbH.

PPT Vision, Inc. has granted us an exclusive open-ended license that allows us to incorporate a patented neural network algorithm in our products. AutoData Systems Division uses this algorithm in its character recognition technology.

Governmental Approvals

We are not required to obtain governmental approval of our products.

Effect of Governmental Regulations

We do not believe that any existing or proposed governmental regulations will have a material effect on our business.

Research and Development

We invest in research and development programs to develop new products in related markets and to integrate state of the art technology into existing products.

Research and development expense (by division) during the past two fiscal years was:

Production Monitoring Division:

2009: $442,000
2008: $431,000

Our development projects for this division are undertaken based upon the identified specific needs of our customer base.

AutoData Systems Division:

2009: $201,000
2008: $199,000

We have continued to fund the AutoData Systems Division s development activities. The goal is to create low-cost software-based systems that enable accurate reading of hand-printed characters and other form elements used on paper forms, as well as software that allows creation of forms that are completed online when participants click on a URL generated by the software, with storing of the form data on an AutoData secure server and retrieval by the software to a database for built-in reports and analysis.

Our future success is dependent in part upon our ability to develop new products in our varying segments. Difficulties or delays in our ability to develop, produce, test and market new products could have a material adverse effect on future sales growth.

Compliance with Environmental Laws

Compliance with federal, state and local environmental provisions has only a nominal effect on current or anticipated capital expenditures and has had no material effect on earnings or on our competitive position.

Employees

As of March 4, 2010, we had 32 employees, of which 31 are full-time and one is part-time. We believe that our relations with our employees are good.

Our ability to maintain a competitive position and to continue to develop and market new products depends, in part, on our ability to retain key employees and qualified personnel. If we are unable to retain and/or recruit key employees, product development, marketing and sales could be negatively impacted.

Fluctuations in Operating Results. We have experienced fluctuations in our operating results in the past, and may experience fluctuations in the future, which may affect the market price of our Common Stock. Sales can fluctuate as a result of a variety of factors, many of which are beyond our control. Some of theses factors are: product competition and acceptance, timing of customer orders, cancellation of orders, the mix of products sold, downturns in the market and economic disruptions. Because fluctuations can happen, we caution investors that results of our operations for preceding periods may not be indicative of how we will perform in the future. There can be no assurance that we will experience continued earnings growth.

Further, investments held by our subsidiary, ESI Investment Company, are subject to significant positive and negative changes in value. In particular, our significant investment in Rudolph Technologies, Inc. has experienced substantial value fluctuations, both negative and positive, which are expected to continue. Our current intention is to continue to gradually liquidate our investment securities to finance our working capital needs as required.

Expending Funds for Changes in Industry Standards, Customer Preferences or Technology. Our business depends upon periodically introducing new and enhanced products and solutions for customer needs. The development of products requires us to commit financial resources, personnel and time, usually in advance of significant market demand for such products. In order to compete, we must anticipate both future demand and the technology available to meet that demand. There can be no assurance that our research and development efforts will lead to new products or product innovations that can be made available to or will be accepted by the market.

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Cautionary Statements

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by us or on our behalf. We have made, and may continue to make, forward-looking statements with respect to our business and financial matters, including statements contained in this document, other filings with the Securities and Exchange Commission, and reports to shareholders. Forward-looking statements generally include discussion of current expectations or forecasts of future events and can be identified by the use of terminology such as believe, estimate, expect, intend, may, could, will, and similar words or expressions. Any statement that does not relate solely to historical fact sh considered forward-looking. Our forward-looking statements generally relate to our growth strategy, future financial results, product development and sales efforts. Forward-looking statements are made throughout this Annual Report, but primarily in this Item 1 and Item 7 - *Management s Discussion and Analysis of Financial Condition and Results of Operations*, and include statements relating to management s intentions that we not become an investment company, our expectations and intentions with respect to growth, statements relating to management s beliefs with respect to the spending slowdown in our market segments, marketing and product development, our expectations and beliefs with respect to the value of our intellectual property, our beliefs with respect to our competitive position in the marketplace, our intention with respect to gradually liquidating our investment securities to finance working capital needs, our expectations and beliefs with respect to the future performance of our investment securities, the adequacy of our facilities, expansion of the number of our manufacturer s representatives and exclusive distributors, our intention to develop new products, the possibility of acquiring compatible businesses as part of our growth strategy, our expectations with respect to our cash requirements and use of cash, our intention to hold our Treasury Bills until maturity, and our expectations with respect to the continuance of our quarterly dividend payments. Forward-looking statements cannot be guaranteed and actual results may vary materially due to the uncertainties and risks, known and unknown, associated with such statements, including our ability to successfully develop new products and manage our cash requirements. We undertake no obligations to update any forward-looking statements. We wish to caution investors that the following important factors, among others, in some cases have affected and in the future could affect our actual results of operations and cause such results to differ materially from those anticipated in forward-looking statements made in this document and elsewhere by us or on our behalf. It is not possible to foresee or identify all factors that could cause actual results to differ from expected or historical results. As such, investors should not consider any list of such factors to be an exhaustive statement of all risks, uncertainties or potentially inaccurate assumptions. These factors include:

- our ability to successfully develop new products;
- our ability to quickly and successfully adapt to changing industry technological standards;
- our ability to comply with existing and changing industry regulations;
- our ability to manage cash requirements;
- our ability to attract and retain new manufacturer s representatives and exclusive distributors;
- our ability to attract and retain key personnel, including senior management;
- our ability to adapt to changing economic conditions and manage downturns in the economy in general; and
- our ability to keep pace with competitors, some of whom are much larger and have substantially greater resources than us.

Item 1A. Risk Factors.

Not applicable.

Item 2. Properties.

We own and occupy a 25,400 square foot facility at 6111 Blue Circle Drive, Minnetonka, Minnesota 55343. All operating entities are located within this facility. The facility is in excellent condition and we continue to maintain and update the facility as necessary. The facility is anticipated to be adequate for our needs in 2010.

Item 3. Legal Proceedings.

We were not the subject of any legal proceedings as of the date of this filing. We are not aware of any threatened litigation.

Item 4. [Reserved]

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our Common Stock trades on the Nasdaq Capital Market of The Nasdaq Stock Market® under the symbol ELSE . The following table sets forth the quarterly high and low reported last sales prices for our Common Stock for each period indicated as reported on the Nasdaq system.

	Period	High	Low
2009	First Quarter	$ 3.59	$ 1.69
	Second Quarter	$ 3.15	$ 2.03
	Third Quarter	$ 3.11	$ 2.35
	Fourth Quarter	$ 4.18	$ 2.74
2008	First Quarter	$ 5.92	$ 4.27
	Second Quarter	$ 5.53	$ 4.25
	Third Quarter	$ 4.96	$ 3.71
	Fourth Quarter	$ 3.99	$ 2.51

Based on data provided by our transfer agent, management believes that as of March 5, 2010, the number of share owner accounts of record was approximately 117.

We paid cash dividends on our Common Stock of $0.16 per share in 2009 and 2008.

From time to time, we may be required to repurchase some of our securities as a result of obligations described in Note 9 to our 2009 consolidated financial statements. We did not repurchase any equity securities during the years ended December 31, 2009 and 2008.

Item 6. Selected Financial Data.

Not applicable.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

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.

RESULTS OF OPERATIONS

Comparison of Fiscal Year 2009 vs. Fiscal Year 2008

Net Revenues

Net revenues for fiscal year 2009 decreased $828,000 to $5,901,000, or 12.3%, when compared to net revenues for fiscal year 2008.

Net revenues for the Production Monitoring Division decreased to $5,521,000, a decrease of $672,000, or 10.9%, when comparing fiscal year 2009 to fiscal year 2008. The Production Monitoring Division experienced a decrease in net sales for the year ended December 31, 2009 due in large part to the lagging world-wide economy. We continue to be impacted by a slowing of capital spending on plant construction and expansion projects in 2009, which has affected all product categories. The recent economic turmoil has resulted in a slowdown in spending across all of our major market segments, which management expects to continue into 2010. We have continued to expand the joint sales calls and training with all of our sales channel partners in order to increase their knowledge and our continued outreach to our clients. Throughout 2010, we expect to continue to expand the number of manufacturer s representatives and exclusive distributors. Our corporate web site provides significant information and product application knowledge to existing and prospective customers and also direct knowledge to our sales partners. New products developed and added to the product line in 2009 include an expanded Electro-Sentry Hazard Monitoring system & new versions of various sensors for hazardous installations.

We will continue to develop new products that broaden the Electro-Sentry hazard monitoring line and provide complete monitoring solutions to our customers. The customers for our Production Monitoring Division have diverse applications for our products in the grain, feed, bio-fuels, power generation, mining, chemical, and other processing areas. We are continuing to look for new industries to expand sales for our Production Monitoring Division. We may also consider acquiring compatible businesses as part of our growth strategy.

Net revenues for the AutoData Systems Division decreased to $380,000, a decrease of $156,000, or 29.1%, when comparing fiscal year 2009 to fiscal year 2008. This decrease was primarily due to decreased sales of the ExpertScan and Scannable Office software products and related hardware needs due to the general economic slowdown and the uncertainty of the impact the pending healthcare reform may have on the revenues of our healthcare customers.

NetE-nable, the web add-on to ExpertScan software, was released at the end of August 2007. ExpertScan with NetE-nable makes automated data collection faster, easier and more cost-effective. After initially slow sales because of the number of established competitors in the online form market, sales of NetE-nable remained steady throughout 2008. Sales in 2009 slowed significantly, however, due to the funding for non-profits and governmental entities tightening as a result of the economic turmoil during 2009. However, NetE-nable has the competitive advantage of offering one software program for both paper and electronic forms, and AutoData expects additional revenue from sales of NetE-nable to gradually return and increase during 2010, augmenting revenue from the ExpertScan and Scannable Office software programs.

Cost of Sales

Our cost of sales decreased from $2,546,000 to $2,436,000, a difference of $110,000, or 4.3%, when comparing fiscal year 2009 to fiscal year 2008. This decrease was primarily a result of decreased sales. We continue our efforts to maintain or reduce production costs by manufacturing products in the most cost effective manner. We continually look for lower cost sources of raw materials and outsource PC Board assembly when appropriate.

Gross Margins

Gross margin for the fiscal year 2009 was 58.7% versus 62.2% for the prior fiscal year. The decrease in gross margin was due to an increase in relative sales volume of lower margin, higher-priced items within the Production Monitoring Division. Gross margin for the Production Monitoring Division for the fiscal year ending December 31, 2009 and 2008 was 56.7% and 59.8%, respectively. The primary cause of the decrease in the gross margin was due to an increase in relative sales volume of lower margin, higher-priced items. Gross margin for the AutoData Systems Division for the fiscal year ending December 31, 2009 and 2008 was 88.7% and 89.1%, respectively. The decrease was due to a larger hardware sales dollar volume in fiscal year 2009. Gross margins on hardware are smaller than the gross margins on software.

Operating Expenses

Total operating expenses decreased by $211,000, or 6.5%, when comparing fiscal year 2009 to fiscal year 2008. Of this increase, the Production Monitoring Division contributed a decrease in operating expenses of $174,000, or 6.2%, when comparing fiscal year 2009 to fiscal year 2008. The AutoData Systems Division had a decrease in operating expenses of $37,000, or 8.4%, when comparing fiscal year 2009 to fiscal year 2008.

Selling and marketing costs decreased by $167,000, or 11.4%, when comparing fiscal year 2009 to fiscal year 2008. Of this decrease, the Production Monitoring Division had a decrease of $129,000, or 9.9%. The AutoData Systems Division had a decrease of $38,000, or 22.5%. The decrease from the Production Monitoring Division was due to a decrease in outside sales representatives commission due to the decrease in sales, travel expenses, tradeshows, and advertising. The decrease from the AutoData Systems Division was due to decreases in salaries and wages and benefit expense due to a decrease in personnel in marketing, a decrease in commission expenses due to decreased sales, and decreased advertising.

General and administrative costs decreased by $57,000, or 4.9%, in fiscal year 2009 compared to fiscal year 2008. Of this decrease, the Production Monitoring Division had a decrease of $56,000, or 5.1%. This decrease was primarily due to decreases in computer supplies and maintenance expenses, credit card processing fees (due to decreased sales and a decrease in rates), and depreciation expense on furniture and fixtures, offset by an increase in the cost of employee retirement programs. The AutoData Systems Division had a decrease of $1,000, or 1.4%. The decrease for the AutoData Systems Division was due to a decrease in computer supplies and maintenance expenses, offset by an increase in bad debt expense due to an adjustment in 2008 for the decline in the allowance for doubtful accounts.

Research and development costs increased $13,000, or 2.1%, in fiscal year 2009 when compared with fiscal year 2008. The Production Monitoring Division research and development costs increased $11,000, or 2.5%, and AutoData Systems Division had an increase of $2,000, or 1.0%. The increase in research and development costs in the Production Monitoring Division was due to an increase in lab testing for product certification, offset by a decrease in prototypes, which was mainly for the Electro-Sentry system in 2008. The increase in the AutoData Systems Division was due to an increase in wages and benefits and computer supplies and maintenance expenses, offset by a decrease in contractor expenses for programming related to NetEnable.

Operating Income (Loss)

Operating income for fiscal year 2009 was $411,000, compared to operating income of $918,000 in 2008, a decrease of $507,000 or 55.2%.

The Production Monitoring Division had operating income of $478,000 compared to operating income of $882,000 in 2008, a decrease of $404,000, or 45.8%. The decrease in operating income was mainly due to a decrease in net sales (due in large part to fluctuations of commodity grain and feed product prices worldwide, which negatively impacted the business of several of our customers), a decrease in our overall gross margin (from 59.8% to 56.7%, primarily due to an increase in relative sales volume of lower margin, higher-priced items), and an increase in the percentage of operating expenses to net sales (from 45.6% of net sales in 2008 to 48.0% of net sales in 2009).

The AutoData Systems Division had an operating loss of $67,000 in fiscal 2009 compared to an operating income of $36,000 for fiscal 2008, a decrease of $103,000, or 286.1%. This decrease in operating income was due primarily to a decrease in sales of software and hardware.

Non-Operating Income

ESI Investment Company continues to provide us with an alternative source of earnings through investments in available-for-sale securities; however, our intent is to remain an operations-based company. Our investments in available-for-sale securities are subject to significant positive and negative changes in value. In addition to income from the sale of investments, we also realize interest income from our short-term holdings.

Investment income for fiscal year 2009 decreased by $48,000 to $24,000. The decrease was driven by a decrease in interest income offset by the recognized loss on a $35,000 investment in Minn Shares, Inc. in 2008. The decrease of 88.3% or $83,000 in interest income earned on temporary cash investments was a result of decreased interest rates on Treasury Bills, which were 2.07% in January 2008 and 0.152% in December 2009.

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 a 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.

Net Income After Tax

We reported net income after tax for fiscal year 2009 of $334,000, as compared to net income of $606,000 in 2008, a decrease of $272,000, or 44.9%. Earnings per share were $0.10 in 2009 compared to earnings per share of $0.18 in 2008.

OFF-BALANCE SHEET ARRANGEMENTS

We are not a party to any off-balance sheet transactions, arrangements or obligations that have, or are reasonably likely to have, a material effect on our financial condition, changes in the financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were $746,000 and $5,529,000 at December 31, 2009 and 2008, respectively. The net decrease in our cash and cash equivalents was $4,783,000 during fiscal year 2009. The decrease was mainly due to the purchase of Treasury Bills with a maturity date of more than three months during 2009. In prior years, we purchased three month Treasury Bills, which we included in cash and cash equivalents.

Cash from operating activities of $707,000 for the year ended December 31, 2009 was primarily a result of our net income adjusted for depreciation expense on capital assets, and changes in accounts receivable, inventories, and income tax activity. Cash from operating activities increased $429,000 for the year ended December 31, 2009 when compared to the year ended December 31, 2008 due to an increase of $543,000 in inventories and a $594,000 increase in accrued income taxes, offset by a $272,000 decrease in net income and a $457,000 decrease in trade receivables. The net change in inventories was due a reduction of $331,000 at December 31, 2009 compared to the prior year and an increase of $212,000 at December 31, 2008 when compared to the prior year. The net change in accrued income taxes was due an increase of $132,000 at December 31, 2009 compared to the prior year and a decrease of $462,000 at December 31, 2008 when compared to the prior year. The net change in trade receivables was due a reduction of $205,000 at December 31, 2009 compared to the prior year and an increase of $252,000 at December 31, 2008 when compared to the prior year.

Cash used in investing activities was $4,968,000 for the year ended December 31, 2009 compared to cash provided by investing activities of $5,000 for the year ended December 31, 2008. The significant increase in cash used for investing activities was due to purchases of Treasury Bills, with a maturity date of more than three months, of $9,949,000, offset by a sale of Treasury Bills of $4,980,000. There were no such purchases or sales during the year ended December 31, 2008 because the Treasury Bills were classified as cash equivalents.

Cash used in financing activities was $522,000 and $533,000 for the years ended December 31, 2009 and 2008, respectively. During the years ended December 31, 2009 and 2008, we paid aggregate dividends of $539,000 each year. During the years ended December 31, 2009 and 2008, we had $9,000 and $6,000, respectively, in stock purchases under the Employee Stock Purchase Plan. Also, in the year ended December 31, 2009, $8,000 in stock options were exercised.

Our ongoing cash requirements will be primarily for capital expenditures, acquisitions, research and development in both the Production Monitoring and AutoData divisions, 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 investments are 343,267 shares of Rudolph Technologies, Inc. (Rudolph), listed on the Nasdaq stock market and 551,759 shares of PPT Vision, Inc (PPT), listed on the Pink Sheets. The Rudolph investment is accounted for using the available-for-sale method. The PPT investment is accounted for under the equity method of accounting. The fair value of the Rudolph investment totaled $2,307,000 and $1,212,000 as of December 31, 2009 and 2008, respectively. The fair value of the PPT investment totaled $39,000 and $33,000 as of December 31, 2009 and 2008, respectively. These stocks are subject to fluctuations in price and could have a negative effect on our liquidity. Liquid securities are periodically sold as deemed appropriate by management. The market value of PPT and Rudolph stock as of February 26, 2010 was $33,000 and $2,732,000, respectively.

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.

Significant estimates, including the underlying assumptions, consist of the 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.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Not applicable.

Item 8. Financial Statements and Supplementary Data.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
Electro-Sensors, Inc. and Subsidiaries
Minnetonka, Minnesota

We have audited the accompanying consolidated balance sheet of Electro-Sensors, Inc. as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in stockholders equity, and cash flows for the fiscal years ended December 31, 2009 and 2008. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated 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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. 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, 2009 and 2008, and the results of their operations and their cash flows for the years ended December 31, 2009 and 2008, in conformity with U.S. generally accepted accounting principles.

/s/ Boulay, Heutmaker, Zibell & Co. P.L.L.P.
Certified Public Accountants

Minneapolis, Minnesota
March 9, 2010

ELECTRO-SENSORS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
(in thousands except share and per share amounts)

	December			
	2009		2008	
ASSETS				
Current assets				
Cash and cash equivalents	**$**	**746**	$	5,529
Treasury Bills		**4,980**		0
Available-for-sale securities		**2,311**		1,215
Trade receivables, less allowance for doubtful accounts of $11 and $8, respectively		**777**		575
Inventories		**908**		1,239
Income tax receivable		**0**		117
Other current assets		**84**		87
Total current assets		**9,806**		8,762
Property and equipment, net		**1,228**		1,336
Total assets	**$**	**11,034**	$	10,098
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities				
Accounts payable	**$**	**79**	$	59
Accrued expenses		**172**		155
Deferred revenue		**76**		86
Accrued income tax		**15**		0
Deferred income tax		**877**		475
Total current liabilities		**1,219**		775
Commitments and contingencies				
Stockholders equity				
Common stock par value $0.10 per share; authorized 10,000,000 shares; issued and outstanding: 3,376,794 and 3,366,880 shares, respectively		**338**		337
Additional paid-in capital		**1,529**		1,513
Retained earnings		**6,578**		6,783
Accumulated other comprehensive income (unrealized gain on available-for-sale securities, net of income tax)		**1,370**		690
Total stockholders equity		**9,815**		9,323
Total liabilities and stockholders equity	**$**	**11,034**	$	10,098

See Notes to Consolidated Financial Statements

ELECTRO-SENSORS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands except share and per share amounts)

	Years ended December 31, 2009		2008	
Net Sales	**$**	**5,901**	$	6,729
Cost of Goods Sold		**2,436**		2,546
Gross Profit		**3,465**		4,183
Operating Expenses				
Selling and marketing		**1,300**		1,467
General and administrative		**1,111**		1,168
Research and development		**643**		630
Total Operating Expenses		**3,054**		3,265
Operating Income		**411**		918
Non-operating Income (Expense):				