

ELECTRO SENSORS INC
Form 10-K
March 20, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-K

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

For the fiscal year ended December 31, 2017

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

Commission file number 000-09587

ELECTRO-SENSORS, INC.

(Exact name of registrant as specified in its charter)

Minnesota
(State or other jurisdiction of incorporation or organization)

41-0943459
(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 No

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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 No

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 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 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.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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
		Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes
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 \$5,300,000 based upon the closing price of its common stock as reported on The Nasdaq Stock Market® on June 30, 2017.

The number of shares outstanding of the registrant's Common Stock, \$0.10 par value, on March 19, 2018 was 3,395,521.

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.

ELECTRO-SENSORS, INC.
Form 10-K for the Year Ended December 31, 2017

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PART I

Item 1. Business.

Introduction

Electro-Sensors, Inc. (“we,” “us,” “our,” the “Company” or “ESI”) manufactures and sells industrial production monitoring and process control systems.

In addition, we may periodically make strategic investments in other businesses and companies, including investments that we believe would facilitate the development of technology complementary to our existing products or investments that we believe present good opportunities for the Company and its shareholders. Our primary focus is to remain an operating company and we do not intend to become an investment company.

ESI was incorporated in Minnesota in July 1968. Our executive offices are located at 6111 Blue Circle Drive, Minnetonka, Minnesota, 55343-9108. Our telephone number is (952) 930-0100.

Products

We manufacture and sell a variety 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.

Our goal is to develop meaningful annual updates to our standard products.

We have a sales agreement with Motrona GmbH, a German control and interface devices manufacturer, under which we have the right to distribute Motrona products in the United States. These products interface with our products on various applications for motion monitoring.

Speed Monitoring Systems

Our speed monitoring systems compare revolutions per minute or speed against acceptable rates as determined by our customers. These systems vary in complexity, from simple systems that detect 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.

Our speed monitoring systems also include a line of products that measure production counts or rates, such as parts, gallons per minute, or board feet. These 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.

We have several products used in drive control systems that regulate the speed of motors on related machines in a production sequence to ensure that the performances of various operations are coordinated. The products consist 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.

Temperature Application Products

Our main temperature applications include bearing, gear box, and motor temperature monitoring. The sensors alert an operator when the temperature exceeds or is less than a specified temperature.

Position Application Products

We also offer production monitoring devices that include a belt alignment and slide gate position monitor. The belt alignment monitor is used to determine if a belt is tracking correctly. The slide gate position monitor is used in plant operations to provide feedback of the position of a slide gate. It is also used to provide feedback of the position of a valve or control arm.

Vibration Monitoring Products

A vibration monitor alerts an operator when the vibration of a machine in a production system exceeds or is less than a specified level.

Tilt Switches

A tilt switch is designed to alert the operator when a storage bin or production system reaches a certain capacity.

Hazard Monitoring Systems

Electro-Sentry We offer the Electro-Sentry 1 and Electro-Sentry 16 hazard monitoring systems, which integrate our sensors for monitoring temperature, belt misalignment, and shaft speed with programmable control logic and LED display interface to create a complete system for hazard monitoring. The systems enable our customers to locate which part of their material handling system is operating incorrectly, typically in less than ten seconds, by using visual indication on the LED displays.

HazardPRO™ We market our wireless hazard technology monitoring system under the HazardPRO product name. This integrated hazard monitoring system captures and displays key information in an intuitive format allowing the user to quickly and comprehensively understand the status and history of its processes. The simple but powerful interface gives the user insight into its operations as it strives to maximize safety and facility runtime, while minimizing costs associated with unscheduled maintenance and unplanned downtime. We offer Class II Div I intrinsically safe nodes and sensors that are certified for use in hazardous environments.

During 2017, we updated the HazardPRO software to include a large site system manager link. The link is used to efficiently collect data from sensors placed across a widely dispersed area and has been deployed in sites covering greater than 50 acres. We also added a complete antenna pair mounting system for easy and accurate customer installation.

We expect to continue to expend resources to develop new products and to market new and existing products for use in a wide variety of monitoring applications.

Our corporate web site provides significant information and product application knowledge to existing and prospective customers and our sales partners. Information on our website is not incorporated by reference herein and

is not a part of this Form 10-K.

Marketing and Distribution

We sell our products primarily through both our internal sales team and a number of manufacturer's representatives and distributors located throughout the United States, Canada, Mexico, Bolivia, Chile, Colombia, Guatemala, Peru, United Kingdom, Ukraine, Egypt, Saudi Arabia, India, Indonesia, Australia, New Zealand, China, Taiwan, Korea, Vietnam, Malaysia, Philippines, and Singapore. Sales to customers outside the United States represent approximately 10% of our 2017 sales. We sell our products under the Electro-Sensors, Inc. brand as a range of products from simple sensors to complex integrated monitoring systems. Our customers are businesses in a wide variety of industries, including grain/feed/milling, bulk materials, manufacturing, food products, ethanol, power generation, and other processing industries.

We continue to explore new industries to expand sales and may also consider acquiring compatible businesses or product lines as part of our growth strategy. In addition, we may make investments that we believe present good opportunities for the Company and its shareholders.

We believe that a wide variety of organizations could achieve significant savings in both time and materials by adding production monitoring and drive control technology to existing processes to coordinate the operation of related machines. We sell our products into both the "retro-fit" market and into new manufacturing or processing systems.

We advertise in national industrial periodicals that cover a range of industrial products and attend several local, national and international tradeshows designated for the industry throughout the year. We also use our corporate website and other related industry websites for advertising and marketing purposes.

Competition

We face substantial competition in the sale of our production monitoring systems from a broad range of industrial and commercial businesses. Many of these competitors are well established and have greater sales volume. Among our larger competitors are Danaher Controls, Red Lion Controls, 4B Elevator Components Ltd., and Durant Corporation. We believe our competitive advantages include our products superior design and quality, the fact that we sell our products as ready-to-install units, and that our products can be used in 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.

Suppliers

We purchase parts and materials for our systems from various manufacturers and distributors. In some instances, these materials are manufactured in accordance with our proprietary designs. Multiple sources of these parts and materials are generally available, and we do not depend on any single source for these supplies and materials. We have not experienced any significant problem of short supply or delays from our suppliers.

Customers

We do not depend upon a single or a few customers for a material (10% or more) portion of our sales.

Patents, Trademarks and Licenses

The Company relies on a combination of patent, trademark, and trade secret laws to establish proprietary right in its products.

We have registered the name “Electro-Sensors” as a trademark with the U.S. Patent and Trademark Office (“USPTO”), Reg. No. 1,142,310. We believe this trademark has been and will continue to be useful in developing and protecting market recognition for our products. We established the HazardPRO trademark in the first quarter of 2014 and intend to register this trademark.

We hold six patents relating to our production monitoring systems. We believe strongly in protecting our intellectual property and have a long history of obtaining patents, when available, in connection with our research and product development programs. We also rely upon trade secrets and proprietary know-how.

We seek to protect our trade secrets and proprietary intellectual property, including know-how, in part, through confidentiality agreements with employees, consultants, and other parties. We cannot ensure, however, that these agreements will not be breached, that we would have adequate remedies for any breach, or that our trade secrets will not otherwise become known or independently developed by competitors.

Business Development Activities

We continue to seek growth opportunities, both internally through our existing portfolio of products, technologies and markets, as well as externally through technology partnerships or related-product acquisitions. In addition, we may make investments that we believe present good opportunities for the Company and its shareholders.

Governmental Approvals

Although, we are not required to obtain governmental approval of our products, we choose to obtain certain third party certifications to meet our customers' needs. These certifications may expand our market opportunities in certain industries.

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 (dollars in thousands)

We invest in research and development programs to develop new products in related markets and to integrate state-of-the-art technology into our existing products. We incurred research and development expenses of approximately \$812 and \$767 during 2017 and 2016, respectively. We undertake development projects based upon the identified specific needs of the markets we serve.

Our future success depends 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 laws 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 19, 2018, we had 36 employees, all of whom are full-time. We believe that our relations with our employees are good. None of our employees are members of unions.

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 our key employees, or recruit and train others, our product development, marketing and sales could be negatively impacted.

Fluctuations in Operating Results.

We have experienced fluctuations in our past operating results, and expect to 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. These factors include: product competition and acceptance, timing of customer orders, cancellation of orders, the mix of products sold, downturns in the markets we serve and economic disruptions. Because fluctuations may occur, we caution investors that results of our operations for recent periods may not accurately predict how we will perform in the future. We cannot ensure that we will achieve revenue or earnings growth.

Expending Funds for Changes in Industry Standards, Customer Preferences or Technology.

Our business depends on periodically introducing new and enhanced products and solutions for customer needs. Our product development efforts require us to commit financial resources, personnel and time, usually in advance of significant market demand for these products. In order to compete, we must anticipate both future demand and the technology available to meet that demand. We cannot ensure 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.

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 should be considered forward-looking.

Our forward-looking statements generally relate to our growth strategy, future financial results, product development and sales efforts. We make forward-looking statements 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. These include statements relating to our beliefs and expectations and intentions with respect to (i) our growth and profitability, (ii) our marketing and product development, (iii) the value of our intellectual property, (iv) our competitive position in the marketplace, (v) the effect of governmental regulations on our business, (vi) our employee relations, (vii) the adequacy of our facilities, (viii) our intention to develop new products, (ix) the possibility of us acquiring compatible businesses or product lines as part of our growth strategy, and (x) our future cash requirements and use of cash.

Forward-looking statements cannot be guaranteed and our actual results may vary materially due to the uncertainties and risks, known and unknown, associated with these 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 these results to differ materially from those anticipated in forward-looking statements made in this document and elsewhere by us or on our behalf. We cannot 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 these factors to be an exhaustive statement of all risks, uncertainties or potentially inaccurate assumptions. These factors include our ability to:

successfully use our cash and liquid assets to develop or acquire new or complementary products or business lines to increase our revenue and profitability;

ensure that our operational systems, security systems and infrastructure, as well as those of third party vendors, remain free from viruses or cyberattacks;

quickly and successfully adapt to changing industry technological standards;

comply with existing and changing industry regulations;

attract and retain key personnel, including senior management;

adapt to changing economic conditions and manage downturns in the economy in general; and

keep pace with competitors, some of whom are much larger and have substantially greater resources than us.

Item 1A.

Risk Factors.

Not required for smaller reporting companies.

Item 2. Properties.

We own and occupy a 25,400 square foot facility at 6111 Blue Circle Drive, Minnetonka, Minnesota 55343-9108. All our operations are conducted within this facility. The facility is in excellent condition and we continue to maintain and update the facility as necessary. We believe the facility will be adequate for our needs in 2018.

Item 3. Legal Proceedings.

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

Item 4. Mine Safety Disclosures.

Not applicable.

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
2017	First Quarter	\$ 4.60	\$ 3.45
	Second Quarter	\$ 4.15	\$ 3.61
	Third Quarter	\$ 3.84	\$ 2.96
	Fourth Quarter	\$ 5.24	\$ 3.32
2016	First Quarter	\$ 3.75	\$ 3.15
	Second Quarter	\$ 3.61	\$ 3.05
	Third Quarter	\$ 3.92	\$ 3.08

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Fourth Quarter	\$	3.92	\$	3.36
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Based on data provided by our transfer agent, as of February 27, 2018, we had 67 shareholders of record who held 879,052 shares of the Company's common stock. In addition, nominees held an additional 2,516,469 shares for approximately 806 shareholders holding shares in street name.

From time to time, we may be required to repurchase some of our equity securities as a result of obligations described in Note 9 to our 2017 financial statements. We did not repurchase any equity securities during the years ended December 31, 2017 and 2016.

The information required by Item 201(d) is set forth in Item 12 of this Form 10-K.

Item 6.

Selected Financial Data.

Not required for smaller reporting companies

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

The following discussion should be read in conjunction with our financial statements and related notes. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated due to various factors discussed under “Forward-Looking Statements” elsewhere in this Annual Report on Form 10-K.

RESULTS OF OPERATIONS

The following table contains selected financial information, for the periods indicated, from our statements of comprehensive income expressed as a percentage of net sales.

	Years Ended December 31,			2016	
	2017				
Net Sales	100.0	%		100.0	%
Cost of Goods Sold	45.2			45.9	
Gross Profit	54.8			54.1	