ELECTRO SENSORS INC
Form 10-K
March 20, 2019

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, 2018

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	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 No

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 every Interactive Data File required to be submitted 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 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	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 $9,000,000 based upon the closing price of its common stock as reported on The Nasdaq Stock Market® on June 30, 2018.

The number of shares outstanding of the registrant's Common Stock, $0.10 par value, on March 19, 2019 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.

2

ELECTRO-SENSORS, INC.
Form 10-K for the Year Ended December 31, 2018

TABLE OF CONTENTS

PART I	4
Item 1. Business	4
Item 1A. Risk Factors	9
Item 2. Properties	9
Item 3. Legal Proceedings	9
Item 4. Mine Safety Disclosures	9
PART II	9
Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	9
Item 6. Selected Financial Data	9
Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations	10
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	13
Item 8. Financial Statements and Supplementary Data	14
Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure	37
Item 9A Controls and Procedures	37
Item 9B. Other Information	38
PART III	39
Item 10. Directors, Executive Officers and Corporate Governance	39
Item 11. Executive Compensation	39
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	39
Item 13. Certain Relationships and Related Transactions, and Director Independence	40
Item 14. Principal Accountant Fees and Services	40
PART IV	41
Item 15. Exhibits and Financial Statement Schedules	41
Item 16. Form 10K - Summary	41
SIGNATURES	42

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 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 sensors. These 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. These 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 Division I, the industry standard for dust environments, intrinsically safe nodes and sensors that are certified for use in hazardous environments.

The HazardPRO software includes a large site system manager link used to efficiently collect data from sensors placed across a widely dispersed area that has been deployed in sites covering greater than 50 acres. We have also added a complete antenna pair mounting system to the product line 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 website, www.electro-sensors.com, provides significant product application information for our 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 represented approximately 11% of our 2018 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 and applications within the current industries we serve 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 industry tradeshows 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 the fact that our products can be used in a wide range of applications. Our major disadvantages include the fact that our major competitors are larger, have a broader range 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.

Seasonality

Generally, the Company experiences seasonality in the sale of its products with the second and third calendar quarters historically the strongest.

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

We invest in research and development programs to develop new products and to integrate state-of-the-art technology into our existing products. We undertake development projects based upon the identified specific needs of the markets we serve. Our "Management's Discussion and Analysis of Financial Condition and Results of Operations" section describes the nature and amount of our Research and Development expenditures.

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, 2019, we had 33 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 adversely affected.

Fluctuations in Operating Results.

We have experienced fluctuations in our past operating results, and expect to experience fluctuations in the future. These fluctuations 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.

Forward-Looking 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 sol 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.

This item is not required for smaller reporting companies, but above under "*Forward-Looking Statements*," we discuss some of the risk factors that are relevant to our business and operating results.

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 2019.

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."

Based on data provided by our transfer agent, as of February 26, 2019, we had 72 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 694 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 10 to our 2018 financial statements. We did not repurchase any equity securities during the years ended December 31, 2018 and 2017.

The information required by Item 201(d) of SEC Regulation S-K 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 (loss) expressed as a percentage of net sales.

	Years Ended December 31, 2018		2017	
Net Sales	100.0	%	100.0	%
Cost of Goods Sold	46.0		45.2	
Gross Profit	54.0		54.8	
Operating Expenses				
Selling and marketing	21.8		18.7	
General and administrative	23.3		20.5	
Research and development	10.8		10.4	
Total Operating Expenses	55.9		49.6	
Operating Income (Loss)	(1.9	)	5.2	
Non-operating Income (Expense)				
Interest income	1.6		0.5	
Other income	0.1		0.1	
Total Non-operating Income, Net	1.7		0.6	
Income (Loss) before Income Taxes	(0.2	)	5.8	
Income Tax Expense (Benefit)	(0.1	)	2.1	
Net Income (Loss)	(0.1	)%	3.7	%

The following paragraphs discuss the Company's performance for years ended December 31, 2018 and 2017.

Comparison of 2018 vs. 2017 (dollars in thousands)

Net Sales

Net sales for 2018 were $7,495, a decrease of $345, or 4.4%, from $7,840 in 2017. Although year- over -year quarterly net sales increased in each 2018 quarter except the second, those increases were more than offset by the decline in the second quarter. The decline in the second quarter was across all product lines and geographies, as we saw general softness in our primary markets. Overall 2018 net sales of our traditional product lines were relatively flat as compared to 2017, while we saw a decrease in net sales of HazardPRO products. Net sales internationally increased slightly in 2018 to 11% of total net sales.

Gross Profit

Gross profit for 2018 decreased $252, or 5.9%, to $4,047 from $4,299 in 2017. Our gross profit margin for 2018 was 54.0% compared to 54.8% in 2017. The slight decrease in the gross margin was primarily due to product mix.

Operating Expenses

Total operating expenses increased $303, or 7.8%, to $4,192 in 2018 from $3,889 in 2017, and increased as a percentage of net sales to 55.9% from 49.6%. The increases in operating expenses was due to additional personnel, legal and professional expenses, and increased expenditures in computer supplies and software.

Selling and marketing expenses increased $165, or 11.2%, to $1,634 in 2018 from $1,469 in 2017, and increased as a percentage of net sales to 21.8% from 18.7%. The increase resulted primarily from expenses related to the hiring of a business development manager during the 2018 first quarter and increased travel expenses; partially offset by a decrease in expenses related to sales demos.

General and administrative expenses increased $137, or 8.5%, to $1,745 in 2018 from $1,608 in 2017, and increased as a percentage of net sales to 23.3% from 20.5%. The increase was primarily due to increases in legal and professional expenses, higher expenses related to computer supplies, software, and testing and the reversal of the HazardPRO contingent earn-out liability of $45 in 2017. The increase was partially offset by a decrease in bonus expense due to decreased revenue and profitability.

Research and development expenses increased $1, or 0.1%, to $813 in 2018 compared to $812 in 2017, and increased as a percentage of net sales to 10.8% from 10.4%. The increase was the result of additional personnel for continuation engineering and product engineering support, offset by a decrease in contract engineering fees related to product enhancements for the HazardPRO product line incurred in 2017.

Operating Income (Loss)

The Company had an operating loss of $145 in 2018 compared to operating income of $410 in 2017, a decrease of $555 or 135.4% and decreased as a percentage of net sales to -1.9% from 5.2%, due primarily to lower revenues and increased operating expenses as discussed above.

Non-Operating Income (Expense)

Non-operating income increased $79 to $127 in 2018 from $48 in 2017, primarily as a result of increased interest income due to higher interest rates on investments.

Available-for-sale equity securities are stated at fair value, and unrealized holding gains and losses are reported in our statement of comprehensive income in the non-operating income (expense) section. All other 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.

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

Income Taxes

Income tax benefit was $8, or (0.1)%, of 2018 net sales compared to income tax expense of $163, or 2.1%, of 2017 net sales. The decrease was due primarily to decreased profitability. In addition, in 2017, we recognized a decrease in our deferred tax asset due a decrease in the corporate federal tax rate from 35% to 21%. In December 2017, the Tax Jobs and Cuts Act of 2017 was enacted decreasing the highest corporate federal tax rate to 21%. Detailed information on our income taxes are described in Note 11 to our financial statements.

Net Income (Loss) After Tax

We reported a net loss of $10 in 2018 compared to net income of $295 in 2017, a decrease of $305, or 103.4%. Basic and diluted loss per share were $0.00 in 2018, compared to basic and diluted earnings per share of $0.09 in 2017.

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 $1,057 and $963 at December 31, 2018 and 2017, respectively. The increase was mainly due to net cash generated from investing activities, as described below. Working capital was $10,942 at December 31, 2018 compared to $10,651 at December 31, 2017.

Cash generated from operating activities in 2018 and 2017 was $130 and $468, respectively, resulting in a $338 decrease in cash from operating activities. The decrease was primarily due to a net loss in 2018 compared to 2017 net income. The 2018 net loss is due to decreased revenue and higher operating expenses.

Cash generated from investing activities in 2018 was $115, compared to a use of cash of $345 in 2017. The decrease was due to greater investment maturities and $82 less in capital expenditures in 2018.

Cash used in financing activities during 2018 was $151. There was no cash provided by or used in financing activities during 2017. The cash used in 2018 was primarily due to making the final payment on the Harvest Engineering, Inc. contingent earn-out in the 2018 first quarter. In addition, the Company entered into a financing lease for three office copiers during 2018 reported as right-to-use assets. The lease is for 63 months and we had $1 in principal payments on the lease in 2018. Detailed information on our financing lease is described in Note 8 to our 2018 financial statements.

Our ongoing cash usage requirements will be primarily used for capital expenditures, potential acquisitions, investments we believe present good opportunities for the Company and its shareholders, 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.

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. Those 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 long-lived assets, realizability of trade receivables, valuation of deferred tax assets/liabilities, inventory, investments, contingent earn-out, and stock compensation expense. It is at least reasonably possible that these estimates may change in the near term.

Economic lives of long-lived assets

We estimate the economic useful life of long-lived assets used in the business. Expected asset lives may be shortened or an impairment may be recorded based on a change in the expected use of the asset. If the expected life of an asset is shortened or an impairment recorded, it could result in an additional charge to depreciation expense.

Realizability of trade receivables

We estimate our allowance for doubtful accounts based on prior history and the aging of our trade receivables. We are unable to predict which, if any, of our customers will be unable to pay their open invoices at a future date. If an account becomes uncollectible and we are required to write off the balance, we would recognize the amount of the additional expense within general and administrative expenses.

Valuation of deferred tax assets/liabilities

We estimate our deferred tax assets and liabilities based on current tax laws and rates. The tax laws and rates could change in the future to either disallow the deductions or increase/decrease the tax rates. We recognize changes in deferred tax assets and liabilities in the period in which the tax law changes become effective. Any change in our deferred tax assets or liabilities could have a material negative or positive effect on our income tax expense.

Valuation of inventory

We purchase inventory based on estimated demand of products. It is possible that the inventory we have purchased will not be used in the products that our customers need or will not meet future technological requirements. If we are unable to use the inventory in our products and it does not meet future technological requirements, we would be required to remove the items from inventory and expense the amount in cost of goods sold.

Valuation of investments

Our investments in available-for-sale securities are valued at market prices in an open market. The prices are subject to the normal fluctuations that could be either negative or positive. Changes in value of our equity securities affect our profitability as the value fluctuates. Any change in the value of our equity securities could have a material negative or positive effect on our profitability. Changes in the value of our treasury bills do not affect our profitability until the treasury bill is sold. At the time of sale, we recognize the interest earned on the treasury bill.

Valuation of stock-based compensation expense

We estimate the expected life and forfeiture rates of stock options granted when calculating the value of options using the Black-Scholes-Merton model. The actual life and forfeiture rate could differ from what we estimated. Changes in the life or forfeiture rate of stock options could have a negative or positive impact on our stock-based compensation.

Valuation of the contingent earn-out

We estimated the probability of meeting the revenue targets over the measurement period to determine the fair value of the contingent liability. The actual payout could be more or less than what we have estimated. If the payout or projected payout is more than the recorded value, we would recognize an additional charge to general and administrative expense. If the payout or projected payout is less than the recorded value, we would recognize a decrease in expense to general and administrative expense. There were no contingent earn-outs as of December 31, 2018.

Additional information regarding our significant accounting policies is provided below in Part II, Item 8, Financial Statements and Supplementary Data – Notes to Financial Statements, Note 1, Nature of Business and Significant Accounting Policies.

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

Not applicable.

Item 8. Financial Statements and Supplementary Data.

INDEX TO FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm	15
Financial Statements	
Balance Sheets	16
Statements of Comprehensive Income (Loss)	17
Statements of Changes in Stockholders' Equity	18
Statements of Cash Flows	19
Notes to Financial Statements	20

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Electro-Sensors, Inc.

Opinion on the Financial Statements

We have audited the accompanying balance sheets of Electro-Sensors, Inc. (the Company) as of December 31, 2018 and 2017, and the related statements of comprehensive income (loss), changes in stockholders' equity, and cash flows for each of the years in the two-year period ended December 31, 2018, and the related notes (collectively referred to as the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

Change in Accounting Principle

As discussed in Note 1 to the financial statements, the Company has changed its method of accounting for revenue in 2018 due to the adoption of FASB Accounting Standards Codification (Topic 606), *Revenue from Contracts with Customers.*

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, **but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.**

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Boulay PLLP

We have served as the Company's auditor since 2006.

Minneapolis, Minnesota

March 20, 2019

ELECTRO-SENSORS, INC.

BALANCE SHEETS

(in thousands except share and per share amounts)

	December 31	
	2018	2017
ASSETS		
Current assets		
Cash and cash equivalents	$ 1,057	$ 963
Treasury bills	7,697	7,711
Available-for-sale securities	45	45
Trade receivables, less allowance for doubtful accounts of $11	896	902
Inventories	1,618	1,552
Other current assets	155	141
Income tax receivable	0	45
Total current assets	11,468	11,359
Deferred income tax asset	192	182
Intangible assets, net	565	800
Property and equipment, net	1,050	1,074
Total assets	$ 13,275	$ 13,415
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities		
Contingent earn-out	$ 0	$ 150
Current maturity of financing lease	**5**	0
Accounts payable	116	178
Accrued expenses	405	380
Total current liabilities	526	708
Long-term liabilities		
Financing lease, net of current maturities	24	0
Total long-term liabilities	24	0
Commitments and contingencies		
Stockholders’ equity		

Common stock par value $0.10 per share; authorized 10,000,000 shares; 3,395,521 shares issued and outstanding	339	339
Additional paid-in capital	2,019	2,004
Retained earnings	10,335	10,352
Accumulated other comprehensive gain (unrealized gain on available-for-sale securities, net of income tax)	32	12
Total stockholders' equity	12,725	12,707
Total liabilities and stockholders' equity	$ 13,275	$ 13,415

See Notes to Financial Statements

ELECTRO-SENSORS, INC.

STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands except share and per share amounts)

	Years ended December 31, 2018	2017
Net Sales	$ 7,495	$ 7,840
Cost of Goods Sold	3,448	3,541
Gross Profit	4,047	4,299
Operating Expenses		
Selling and marketing	1,634	1,469
General and administrative	1,745	1,608
Research and development	813	812
Total Operating Expenses	4,192	3,889
Operating Income (Loss)	(145)	410
Non-operating Income (Expense)		
Interest expense	(1)	0
Interest income	**120**	38
Other income	8	10
Total Non-operating Income, Net	127	48
Income (Loss) before Income Taxes	(18)	458
Income Taxes Expense (Benefit)	(8)	163
Net Income (Loss)	(10)	295
Other Comprehensive Income		
Change in unrealized value of available-for-sale securities, net of income tax	13	41
Other Comprehensive Income	13	41
Net Comprehensive Income	$ 3	$ 336
Net Income (Loss) per share data		
Basic		
Net income (loss) per share	$ 0.00	$ 0.09
Weighted average shares	3,395,521	3,395,521
Diluted		

Net income (loss) per share	$ 0.00	$ 0.09
Weighted average shares	3,395,521	3,401,017

See Notes to Financial Statements

ELECTRO-SENSORS, INC.
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(in thousands except share and per share amounts)

	Common Stock Issued		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount				
Balance, December 31, 2016	3,395,521	$ 339	$ 1,953	$ 10,057	$ (29)	$ 12,320
Other comprehensive income					41	41
Stock-based compensation expense			51			51
Net income				295		295
Balance, December 31, 2017	3,395,521	339	2,004	10,352	12	12,707
Other comprehensive income					13	13
Stock-based compensation expense			15			15
Change in accounting policy				(7)	7	**0**
Net loss				(10)		(10)
Balance, December 31, 2018	3,395,521	$ 339	$ 2,019	$ 10,335	$ 32	$ 12,725

See Notes to Financial Statements

ELECTRO-SENSORS, INC.
STATEMENTS OF CASH FLOWS

(in thousands)

	Years ended December 31, 2018	2017
Cash flows from operating activities		
Net income (loss)	$ (10)	$ 295
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation and amortization	321	308
Deferred income taxes	**(16)**	(4)
Change in contingent earn-out fair value	0	(45)
Stock-based compensation expense	15	51
Interest accrued on treasury bills	**(114)**	(37)
Other	0	3
Change in:		
Trade receivables	6	(135)
Inventories	(66)	(37)
Other current assets	(14)	33
Accounts payable	(62)	(61)
Accrued expenses	25	76
Income taxes receivable	45	21
Net cash from operating activities	130	468
Cash flows from (used in) investing activities		
Purchases of treasury bills	(14,353)	(8,681)
Proceeds from the maturity of treasury bills	14,500	8,450
Purchase of property and equipment	(32)	(114)
Net cash from (used in) investing activities	115	(345)
Cash flows used in financing **activities**		
Payments on financing lease	**(1**)	0
Payment of contingent earn-out	(150)	0
Net cash used in financing activities	(151)	0
Net increase in cash and cash equivalents	94	123
Cash and cash equivalents, beginning	963	840
Cash and cash equivalents, ending	$ 1,057	$ 963

Supplemental cash flow information		
Cash paid during the year for income taxes	$ 1	$ 196
Cash paid during the year for interest	$ 1	$ 0
Supplemental disclosures of non-cash investment and financing activity		
Right-of-use assets obtained in exchange for finance lease obligations	$ 30	$ 0

See Notes to Financial Statements

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

Note 1. Nature of Business and Significant Accounting Policies

Nature of business:

Electro-Sensors, Inc. manufactures and markets a complete line of monitoring and control systems for a variety of industrial machinery. The Company uses leading-edge technology to continuously improve its products, with the ultimate goal of manufacturing the industry-preferred product for each market served. The Company sells these products through an internal sales staff, manufacturer's representatives, and distributors to a wide variety of industries that use the products in a variety of applications to monitor process machinery operations. The Company markets its products to customers located throughout the United States, Canada, Latin America, Europe, and Asia.

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. See Note 2 for additional information regarding the Company's investments. The Company's investments in securities are subject to normal market risks.

Significant accounting policies of the Company are summarized below:

Use of estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America (US GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates, including the underlying assumptions, consist of the economic lives of long lived assets, realizability of trade receivables, valuation of deferred tax assets/liabilities, inventory, investments, contingent earn-out, and stock compensation expense. It is at least reasonably possible that these estimates may change in the near term.

Cash and cash equivalents

The Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents are invested in commercial paper, money market accounts and may, also, be invested in three-month Treasury Bills. Cash equivalents are carried at cost plus accrued interest which approximates fair value.

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

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

Trade receivables and credit policies

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

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

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

As of December 31, 2018, the Company had one customer that accounted for approximately 12% of outstanding accounts receivable. As of December 31, 2017, there were no customers that exceeded 10% of the accounts receivable balance.

Available-for-sale securities

The Company's investments have traditionally consisted of government debt securities and equity securities, primarily common stock. The estimated fair value of publicly traded equity securities is based on reported market prices or management's reasonable market price when quoted prices are not available, 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 this classification at each balance sheet date.

Since the Company generally does not make investments in anticipation of short-term fluctuations in market price, the Company classifies its investments in equity securities and treasury bills as available-for-sale. Treasury bills 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 a separate component of stockholders' equity and within accumulated other comprehensive gain. Unrealized gains and losses on equity securities are reported in the statement of comprehensive income in non-operating income.

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 statement of comprehensive income. Realized gains and losses are determined on the basis of the specific securities sold. There were no other-than-temporary impairments recognized in the years ended December 31, 2018 and 2017.

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

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 financial statements on a recurring basis. These policies also incorporate the guidance for fair value measurement related to nonfinancial items that are recognized and disclosed at fair value in the 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 Company currently has no nonfinancial or financial items that are measured on a nonrecurring basis.

The carrying value of cash equivalents, trade receivables, accounts payable, and other financial working capital items approximate fair value at December 31, 2018 and 2017 due to the short term maturity nature of these instruments.

Inventories

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

Property and equipment

Property and equipment are stated at cost. Depreciation is provided over estimated useful lives by use of the straight-line method. Maintenance and repairs are expensed as incurred. Major improvements and betterments are capitalized.

Long-lived assets, such as property and equipment and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require the Company to test a long-lived asset for possible impairment, the Company first compares undiscounted cash flows expected to be generated by an asset to the carrying value of the asset. If the carrying value of the long-lived asset is not recoverable on an undiscounted cash flow basis, the Company recognizes impairment to the extent that the carrying value of an asset exceeds its fair value. The Company determines fair value through various valuation techniques including, but not limited to, discounted cash flow models, quoted market values and third-party independent appraisals.

Estimated useful lives are as follows

	Years
Equipment	5- 10
Furniture and Fixtures	3 - 7
Building	7- 40

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

Intangible assets

Intangible assets are comprised of a non-compete agreement and the HazardPROTM technology. The Company amortizes the cost of these intangible assets on a straight-line method over the estimated useful lives.

Revenue recognition

At contract inception, the Company assesses the goods and services promised to a customer and identifies a performance obligation for each promised good or service that is distinct. In addition, the transaction price for each performance obligation is determined at contract inception. Our contracts, generally in the form of a purchase order, specify the product or service that is promised to the customer. The typical contract life is less than one month and contains a single performance obligation, to provide conforming goods or services to the customer. Occasionally, we have a second performance obligation which is, typically, the startup of the HazardPRO product. For contracts that have multiple performance obligations, the transaction price is allocated to each performance obligation using the relative stand-alone selling price. We generally determine stand-alone selling prices based on the observable stand-alone prices charged to customers. We recognize product revenue at the point in time when control of the product is transferred to the customer, which typically occurs when products are shipped. We recognize service revenue at the point in time when the service has been provided.

Advertising costs

The Company expenses advertising costs as incurred. Total advertising expense was $48 and $76 in 2018 and 2017, respectively.

Research and development

Expenditures for research and development are expensed as incurred. The Company incurred expenses of $813 and $812 in 2018 and 2017, respectively.

Income taxes

The Company presents deferred income taxes on an asset and liability approach to financial accounting and reporting for income taxes. The Company annually determines the difference between the financial reporting and tax bases of assets and liabilities. The Company computes deferred income tax assets and liabilities for those differences that have future tax consequences using the currently enacted tax laws and rates that apply to the periods in which these laws 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 asset or liability allocated to other comprehensive gain (loss). Deferred taxes are reduced by a valuation allowance to the extent that realization of the related deferred tax asset is not certain. We recorded a valuation allowance on our deferred tax asset of $81 and $28 at December 31, 2018 and 2017, respectively.

The Company recognizes the effect of income tax positions only if those positions are more likely than not to be sustained. The Company recognizes income tax positions at the largest amount that is more likely than not to be realized. The Company reflects changes in recognition or measurement in the period in which the Company's change in judgment occurs.

The Company records interest and penalties related to unrecognized tax benefits in income tax expense.

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

Net income (loss) per common share

Basic earnings per share (EPS) excludes dilution and is determined by dividing net income by the weighted average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that could occur if securities such as options and other contracts to issue common stock were exercised or converted into common stock. For the years ending December 31, 2018 and 2017, respectively, options to purchase 312,158 and 257,500 weighted average common shares have been excluded from the diluted weighted average shares because their effect would be anti-dilutive.

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

	Income (loss)	Shares	Per share amount
2018:			
Basic EPS	$ (10)	3,395,521	$ (0.00)
Effect of dilutive stock options		0	0.00
Diluted EPS	$ (10)	3,395,521	$ (0.00)
2017:			
Basic EPS	$ 295	3,395,521	$ 0.09
Effect of dilutive stock options		5,496	0.00
Diluted EPS	$ 295	3,401,017	$ 0.09

Stock-based compensation

The Company records compensation expense for 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 December 31, 2018, the Company had two stock-based compensation plans.

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

Recently Adopted Accounting Pronouncements

Financial Instruments

In January 2016, the FASB issued Accounting Standards Update No. 2016-01 (ASU 2016-01) "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," which amends various aspects of the recognition, measurement, presentation, and disclosure of financial instruments. The Company adopted ASU 2016-01 as of January 1, 2018 using the modified retrospective method for marketable equity securities. This resulted in a $7 reclassification of net unrealized losses from accumulated other comprehensive income (AOCI) to retained earnings. The adoption of ASU 2016-01 increases the possibility of increased volatility of non-operating income, as a result of the requirement to remeasure our equity securities each reporting period. For further information on unrealized losses from equity securities, see Note 2.

Leases

In February 2016, the FASB issued Accounting Standards Update No. 2016-02 (ASU 2016-02) "Leases (Topic 842)" which was modified in July 2018, Accounting Standards Update No. 2018-11 (ASU 2018-11) "Leases (Topic 842): Targeted Improvements" to increase transparency and comparability among organizations by requiring the recognition of Right of Use ("ROU") assets and lease liabilities on the balance sheet. Most prominent among the changes in the standard is the recognition of ROU assets and lease liabilities by lessees for those leases classified as operating leases. Under the standard, disclosures are required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. We elected to early adopt the standard effective October 1, 2018 in conjunction with the Company entering into a financing lease using the optional effective date method. The standard did not have a material impact in our balance sheets, statements of comprehensive income (loss), or statement of cash flows compared to the legacy accounting guidance for leases.

Revenue Recognition

On January 1, 2018, the Company adopted Accounting Standards Codification (ASC) Revenue from Contracts with Customers and all related amendments (the Standard), for all contracts using the modified retrospective method. The Standard implements a five-step process for revenue recognition that focuses on transfer of control and defines a contract as “an agreement between two or more parties that creates legally enforceable rights and obligations." The adoption of the Standard did not significantly impact the timing and measurement of the Company's revenue recognition. As a result, we did not recognize a cumulative effect adjustment to the opening balance of retained earnings.

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

Note 2. Investments

The Company has investments in commercial paper, Treasury Bills, and common equity securities of a private U.S. company. The commercial paper investment is in U.S. debt with ratings of F1+. The Treasury Bills have terms ranging from one month to seven months at December 31, 2018.

The Company classifies its investments in commercial paper and Treasury Bills as available-for-sale accounted for at fair value with unrealized gains and losses recognized in accumulated other comprehensive gain on the balance sheet.

Prior to January 1, 2018, the Company accounted for equity securities at fair value with unrealized gains and losses recognized in accumulated other comprehensive gain on the balance sheet. Realized gains and losses on equity securities sold or impaired were recognized in non-operating income on the statement of comprehensive loss.

On January 1, 2018, the Company adopted ASU 2016-01 which changed the way the Company accounted for equity securities. Equity securities are measured at fair value and starting January 1, 2018 unrealized gains and losses are recognized in non-operating income. Upon adoption, the Company reclassified $7 of net unrealized losses related to equity securities from accumulated other comprehensive gain to retained earnings.

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

	Cost	Gross unrealized gain	Gross unrealized loss	Fair value
December 31, 2018				
Commercial Paper	$ 667	$ 0	$ 0	$ 667
Treasury Bills	7,656	41	0	7,697
Equity Securities	45	0	0	45
	8,368	41	0	8,409
Less Cash Equivalents	667	0	0	667

Total Investments, December 31, 2018	$ 7,701	$ 41	$ 0	$ 7,742
December 31, 2017				
Commercial Paper	$ 568	$ 0	$ 0	$ 568
Treasury Bills	7,687	24	0	7,711
Equity Securities	54	0	(9)	45
	8,309	24	(9)	8,324
Less Cash Equivalents	568	0	0	568
Total Investments, December 31, 2017	$ 7,741	$ 24	$ (9)	$ 7,756

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

Changes in Accumulated Other Comprehensive Income

Changes in Accumulated Other Comprehensive Income are as follows:

	December 31, 2018	2017
Unrealized Gains		
Unrealized holding gains arising during the period	$ 19	$ 49
Less: Reclassification of gains included in net income (loss)	0	0
	19	49
Deferred Taxes on Unrealized Gains:		
Increase in deferred taxes on unrealized gains arising during the period	6	8
Less: Reclassification of taxes on gains included in net income (loss)	0	0
	6	8
Net Change in Accumulated Other Comprehensive Income	$ 13	$ 41

Note 3. Fair Value Measurements

The following table provides information on those assets and liabilities measured at fair value on a recurring basis.

December 31, 2018

	Carrying amount in balance sheet	Fair Value	Fair Value Measurement Using		
			Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents:					

Commercial paper	$ 667	$ 667	$ 667	$ 0	$ 0
Treasury bills	7,697	7,697	7,697	0	0
Equity securities	45	45	0	0	45

December 31, 2017

	Carrying amount in balance sheet	Fair Value	Fair Value Measurement Using Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents:					
Commercial paper	$ 568	$ 568	$ 568	$ 0	$ 0
Treasury bills	7,711	7,711	7,711	0	0
Equity securities	45	45	0	0	45
Liabilities:					
Contingent earn-out	150	150	0	0	150

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts

The fair value of the money market funds, commercial paper, and treasury bills is based on quoted market prices in an active market. Closing prices are readily available from active markets and are used as being representative of fair value. The Company classifies these securities as level 1. The only equity security owned by the Company is an investment in a limited-marketable company. There is an insignificant market for this limited-marketable company and the Company has determined the value based on financial and other factors, which are considered level 3 inputs in the fair value hierarchy. Management estimated the probability of meeting the revenue targets over the measurement period to determine the fair value of the contingent earn-out, which is considered a level 3 input in the fair value hierarchy.

The change in level 3 assets at fair value on a recurring basis is summarized as follows:

	Years Ended December 31,			
	2018		2017	
Beginning Balance	$	45	$	0
Increase in value		0		45
Ending Balance	$	45	$	45

The 2017 increase in value is due to additional information obtained on equity securities held in a company with a limited market for its securities.

The change in level 3 liabilities at fair value on a recurring basis is summarized as follows:

	Years Ended December 31,			
	2018		2017	
Beginning Balance	$	150	$	195
Credit to Earnings		0		(45)
Payments		**(150)**		0
Ending Balance	$	0	$	150

The 2017 decrease in the contingent earn-out, which is recorded in general and administrative expenses, reflects the Company's expectation of lower future contingent payments related to a general manufacturing sector slowdown as well as slower adoption of the Company's wireless product offerings. The 2018 decrease reflects the final payment of the liability according to the terms of the underlying agreement. No liability exists at December 31, 2018.

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts

Note 4. Inventories

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

	December 31, 2018			2017	
Raw Materials	$	968		$	898
Work In Process		309			313
Finished Goods		351			341
Reserve for Obsolescence		**(10**	)		0
Total Inventories	$	1,618		$	1,552

Note 5. Property and Equipment, Net

The following is a summary of property and equipment:

	December 31, 2018		2017	
Construction in Progress - Equipment	$	0	$	90
Equipment		274		273
Furniture and Fixtures		503		414
Right-of-Use Asset		**30**		0
Building		1,370		1,370
Land		415		415
		2,592		2,562
Less Accumulated Depreciation		1,542		1,488
Total Property and Equipment	$	1,050	$	1,074

Depreciation expense for the years ended December 31, 2018 and 2017 was $86 and $73, respectively.

29

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

Note 6. Net Intangible Assets

Intangible assets include the following:

		December 31, 2018		
	Average Useful Lives	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Non-compete	5 Years	$ 120	$ 118	$ 2
Technology	7 Years	1,478	915	563
Net Intangible Assets		$ 1,598	$ 1,033	$ 565

		December 31, 2017		
	Average Useful Lives	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Non-compete	5 Years	$ 120	$ 94	$ 26
Technology	7 Years	1,478	704	774
Net Intangible Assets		$ 1,598	$ 798	$ 800

Amortization expense for the years ended December 31, 2018 and 2017 was $235.

Estimated amortization expense over the next three years is as follows:

2019	$	213
2020	$	211
2021	$	141

Note 7. Accrued Expenses

Accrued expenses include the following:

	December 31,			
	2018		2017	
Wages and Commissions	$	326	$	294
Other		79		86
Total Accrued Expenses	$	405	$	380

30

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

Note 8. Leases

We have a financing lease for office equipment. The lease has a remaining term of five years at December 31, 2018.

The components of lease expense were as follows for the year ended December 31:

		2018
Finance lease cost:		
Amortization of right-of-use assets	$	2
Interest on lease liabilities		1
Total finance lease cost	$	3

Supplemental balance sheet information related to leases is as follows:

		2018
Finance leases		
Property and equipment, gross	$	30
Accumulated amortization		(2)
Property and equipment, net	$	28
Weighted average remaining lease term		
Finance leases		5 years
Weighted average discount rate		
Finance leases		7.0%

Maturities of lease liabilities are as follows:

Year ending December 31		
2019	$	7
2020		7
2021		7
2022		7
2023		6
Total lease payments		34
Less imputed interest		(5)
Total	$	29

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

Note 9. Common Stock Options

Stock options

The 1997 Stock Option Plan (the “1997 Plan”) and 2013 Equity Incentive Plan (the “2013 Plan”) authorize the issuance of both nonqualified and incentive stock options. Payment for the shares may be made in cash, shares of the Company’s common stock or a combination thereof. Under the terms of the plans, incentive stock options and non-qualified stock options are granted at a minimum of 100% of fair market value on the date of grant and may be exercised at various times depending upon the terms of the option. All existing options expire 10 years from the date of grant or one year from the date of death.

Stock-based compensation

Under the 2013 Plan, the Company is authorized to grant options to purchase up to 600,000 shares of its common stock. As of December 31, 2018, options to purchase an aggregate of 325,000 shares were outstanding under the 2013 Plan, of which options to purchase 285,000 shares were exercisable, and 275,000 additional shares were available for issuance pursuant to awards that may be granted under the plan in the future.

Under the 1997 Plan, the Company was authorized to grant options to purchase up to 450,000 shares of its common stock. As of December 31, 2018, options to purchase an aggregate of 7,500 shares were outstanding and exercisable under the 1997 Plan. The board terminated the plan in 2014. The existing grants may be exercised according to the terms of the grant agreements.

During the 2018 fourth quarter, the Company granted an employee options to purchase 25,000 shares of common stock. The options were priced at fair market value and vested 20% on the grant date, with an additional 20% vesting on the first four anniversaries of the grant date. The options expire 10 years from the date of grant.

There were no options granted during 2017. The assumptions made in estimating the fair value of the options on the grant date based upon the BSM option-pricing model for the year ended December 31, 2018 are as follows:

Dividend Yield	0.00%
Expected Volatility	18.79%
Risk Free Interest Rate	3.03%
Expected Life	6 Years

The Company calculates expected volatility for stock options and other awards using historical volatility as the Company believes the expected volatility will approximate historical volatility.

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

The following table summarizes the activity for outstanding incentive stock options under the 2013 Plan to employees of the company:

	Options Outstanding			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (1)
Balance at January 1, 2017	100,000	$ 3.81	8.7	
Granted	0			
Exercised	0			
Canceled/forfeited/expired	0			
Balance at December 31, 2017	100,000	3.81	7.7	
Granted	25,000	3.64	10.0	
Exercised	0			
Canceled/forfeited/expired	0			
Balance at December 31, 2018	125,000	$ 3.78	8.1	
Vested and exercisable as of December 31, 2018	85,000			$ 0

(1) The aggregate intrinsic value is calculated as approximately the difference between the weighted average exercise price of the underlying awards and the Company’s estimated current fair market value at December 31, 2018.

	Options Outstanding			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (1)
Balance at January 1, 2017	207,500	$ 4.62	6.4	
Granted	0			
Exercised	0			
Canceled/forfeited/expired	0			

Balance at December 31, 2017	207,500	4.62	5.4	
Granted	0			
Exercised	0			
Canceled/forfeited/expired	0			
Balance at December 31, 2018	207,500	$ 4.62	4.4	
Vested and exercisable as of December 31, 2018	207,500			$ 0

(1) The aggregate intrinsic value is calculated as approximately the difference between the weighted average exercise price of the underlying awards and the Company’s estimated current fair market value at December 31, 2018.

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

(in thousands except share and per share amounts)

The weighted average grant date fair value of options granted during the year ended December 31, 2018, under the 2013 Plan, was $24. The Company recognized compensation expense of approximately $15 and $51 during the years ended December 31, 2018 and 2017, respectively, in connection with the issuance of the options.

There were no options exercised during the years ended December 31, 2018 and 2017.

As of December 31, 2018, there was approximately $26 of unrecognized compensation expense under the 2013 Plan. The Company expects to recognize this expense over the next four years. To the extent the forfeiture rate is different than we have anticipated; stock-based compensation related to these awards will be different from our expectations.

Note 10. Benefit Plans

Employee stock ownership plan

The Company sponsors an employee stock ownership plan (“ESOP”) that covers substantially all employees who work 1,000 or more hours during the year. The ESOP has, at various times, secured financing from the Company to purchase the Company’s shares on the open market. When the Plan purchases shares with the proceeds of the Company loans, the shares are pledged as collateral for these loans. The shares are maintained in a suspense account until released and allocated to participant accounts. The Plan owns 135,490 shares of the Company’s stock at December 31, 2018. All shares held by the Plan have been released and allocated. No dividends were paid during the years ended December 31, 2018 and 2017. The Plan had no debt to the Company at December 31, 2018 or 2017.

The Company recognized compensation expense for contributions of $24 to the ESOP plan in both 2018 and 2017.

In the event a terminated ESOP participant desires to sell his or her shares of the Company’s stock and the shares are not readily tradable, the Company may be required to purchase the shares from the participant at fair market value. In addition, at its election, the Company may distribute the ESOP’s shares to the terminated participant. At December 31, 2018, 135,490 shares of the Company’s stock, with an aggregate fair market value of approximately $461, are held by ESOP participants who, if terminated, would have rights under the repurchase provisions if the Company's stock were not readily traded. The Company believes that the market for its shares meets the ESOP requirements and that there would not be a current obligation to repurchase shares.

Profit sharing plan and savings plan

The Company has a salary reduction and profit sharing plan that conforms to IRS provisions for 401(k) plans. The Company may make profit sharing contributions with the approval of the Board of Directors. There were no profit sharing contributions by the Company in 2018 or 2017.

ELECTRO-SENSORS, INC.
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2018 AND 2017
(in thousands except share and per share amounts)

Note 11. Income Taxes

The components of the income tax provision for the years ended December 31, 2018 and 2017 are as follows:

	2018	2017
Current:		
Federal	$ 0	$ 167
State	1	0
Deferred:		
Federal	(9)	(31)
State	0	27
Total Federal and State Income Taxes	$ (8)	$ 163

The provision for income taxes for the years ended December 31, 2018 and 2017 differs from the amount obtained by applying the U.S. federal income tax rate to pretax income due to the following:

	2018	2017
Computed “Expected” Federal Tax Expense (Benefit From)	$ (4)	$ 156
Increase (Decrease) in Taxes Resulting From:		
State Income Taxes, net of Federal Benefit	1	3
Credits	(41)	(46)
Domestic Production Activities Deduction	0	(19)
Permanent Differences	7	4
Effect of U.S. Tax Law Changes (35% to 21%)	0	49
Other	29	16
Total Federal and State Income Taxes	$ (8)	$ 163

ELECTRO-SENSORS, INC. AND SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2018 AND 2017
(in thousands except share and per share amounts)

The components of the net deferred tax asset consist of:

	2018	2017
Deferred Tax Assets:		
Vacation accrual	$ 24	$ 23
Allowance for doubtful accounts	2	2
Stock compensation	91	88
Bonus	0	2
Depreciation and amortization	29	17
Inventory Obsolescence	**2**	0
R&D credit carryforward	154	101
Valuation allowance	(81)	(28)
Total Deferred Tax Assets	221	205
Deferred Tax Liabilities:		
Prepaid expenses	20	20
Net unrealized gain on investments	9	3
Total Deferred Tax Liabilities	29	23
Net Deferred Tax Asset	$ 192	$ 182

The Company is materially subject to the following taxing jurisdictions: U.S. and Minnesota. The tax years that remain open to examination by the Internal Revenue Service and state jurisdictions are 2015 through 2017. We have no accrued interest or penalties related to uncertain tax positions as of January 1, 2018 or December 31, 2018 and uncertain tax positions are not significant.

Item 9. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

The person serving as our principal executive officer and principal financial officer evaluated the effectiveness of our 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”). Based on this evaluation, the person serving as the Company’s principal executive officer and principal financial officer has concluded that the Company’s disclosure controls and procedures were not effective as of December 31, 2018 due to the material weakness identified and described in the section below 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.

Management’s Report on Internal Control over Financial Reporting

Under Section 404 of the Sarbanes-Oxley Act of 2002, our management is required to assess the effectiveness of the Company’s internal control over financial reporting as of the end of each fiscal year and report, based on that assessment, whether the Company’s internal control over financial reporting is effective.

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company’s internal control over financial reporting is designed to provide reasonable assurance as to the reliability of the Company’s financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, internal control over financial reporting determined to be effective can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company’s management has assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2018. In making this assessment, the Company used the criteria established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in “Internal Control-Integrated Framework (2013).” These criteria are in the areas of control environment, risk assessment, control activities, information and communication, and monitoring. The Company’s assessment included extensive documenting, evaluating and testing the design and operating effectiveness of its internal control over financial reporting. Based on this evaluation, the person serving as the Company’s principal executive officer and principal financial officer has concluded that the Company’s internal controls were not effective as of December 31, 2018 due to a material weakness in our controls over revenue recognition around period cut off. Remediation efforts have been implemented which primarily consist of training our personnel to properly adhere to our existing controls. We will consider this material weakness to be fully remediated once the applicable controls operate for a sufficient period of time and our management has concluded, through testing, that these controls are operating effectively, which management expects to be completed by March 31, 2019.

Changes in Internal Control over Financial Reporting

Except for the material weakness identified as discussed above, there have been no changes in the Company’s internal control over financial reporting that occurred during the fourth quarter of fiscal year 2018, 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.

Item 9B. <u>Other Information.</u>

None

PART III

Certain information required by Part III is incorporated by reference to the Company's Definitive Proxy Statement pursuant to Regulation 14A (the "2019 Proxy Statement") for its Annual Meeting of Shareholders to be held April 24, 2019 ("Annual Meeting").

Item 10. Directors, Executive Officers and Corporate Governance.

The information required by Item 401 under Regulation S-K, to the extent applicable to the Company's directors, will be set forth under the caption "Election of Directors" in the 2019 Proxy Statement and is incorporated herein by reference. The information required with respect to the Company sole executive officer, who is also a director, will be set forth under the caption "Election of Directors."

The information required by Item 405 regarding compliance with Section 16(a) will be set forth under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the 2019 Proxy Statement, and is incorporated herein by reference.

Code of Ethics and Business Conduct

The Company has adopted the Electro-Sensors Code of Ethics and Business Conduct (the "Code of Conduct") applicable to all officers and employees of the Company. A copy of the Code of Conduct can be obtained free of charge upon written request directed to the Company's Chief Executive Officer at the Company's executive offices. Any amendment to, or waiver from, a provision of our Code of Conduct will be posted to our website.

The information required by Item 407 regarding corporate governance will be set forth under the caption "Corporate Governance" in the 2019 Proxy Statement and is incorporated herein by reference.

Item 11. Executive Compensation.

The information called for by Item 402 under Regulation S-K, will be set forth under the caption "Executive Compensation" in the Company's 2019 Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information called for by Item 403 under Regulation S-K will be set forth under the caption “Security Ownership of Certain Beneficial Owners and Management” in the Company’s 2019 Proxy Statement, and is incorporated herein by reference.

The following table provides information as of December 31, 2018 about the Company’s equity compensation plans.

Equity Compensation Plan Information

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	332,500	$4.30	275,000(1)
Equity compensation plans not approved by security holders	—	—	—
Total	332,500	$4.30	275,000(1)

(1) Shares issuable pursuant to the 2013 Equity Incentive Plan.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by Item 404 under Regulation S-K will be set forth under the caption “Transactions with Related Persons, Promoters and Certain Control Persons” in the 2019 Proxy Statement, and is incorporated herein by reference.

The information required by Item 407(a) will be set forth in the 2019 Proxy Statement under the caption “Corporate Governance” and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services.

The information required by Item 14 of Form 10-K and 9(e) of Schedule 14A will be set forth under the caption “Ratification of Independent Registered Public Accounting Firm” in the Company’s 2019 Proxy Statement, and is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

Financial Statements.

Reference is made to the Index to Financial Statements appearing on Page 14 hereof.

Financial Statement Schedules.

The Financial Statement Schedules have been omitted either because they are not required or because the information has been included in the financial statements or the notes thereto included in this Annual Report.

Exhibits.

Exhibit Number	Exhibit Description
^3.1	Registrant's Restated Articles of Incorporation, as amended—incorporated by reference to Exhibit 3.1 to the Company's 1991 Form 10-KSB
^3.2	Registrant's Bylaws, as amended to date—incorporated by reference to Exhibit 3.2 to the Company's 1997 Form 10-KSB
^*10.1	Electro-Sensors, Inc. 1997 Stock Option Plan —incorporated by reference to Exhibit 10.6 to the Company's 1997 Form 10-KSB
^*10.2	Electro-Sensors, Inc. 2013 Equity Incentive Plan incorporated by reference to Appendix A of the Company's Proxy Statement for the Company's 2016 Annual Meeting of Shareholders
^*10.4	Form of Incentive Stock Option Agreement under the 2013 Equity Incentive Plan – incorporated by reference to Exhibit 10.1 to the Company's Form 8-K filed on April 29, 2013
^*10.5	Form of Non-qualified Stock Option Agreement under the 2013 Equity Incentive Plan – incorporated by reference to Exhibit 10.2 to the Company's Form 8-K filed on April 29, 2013
23.1	Consent of Independent Registered Public Accounting Firm
24.1	Power of Attorney (see Signature page)
31.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	

	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Letter to Shareholders dated March 20, 2019
99.2	Investor Information
101	The following financial information from Electro-Sensors, Inc.'s Annual Report on Form 10-K for the annual period ended December 31, 2018, formatted in eXtensible Business Reporting Language (XBRL): (i) Balance Sheets as of December 31, 2018 and 2017, (ii) Statements of Comprehensive Income for the years ended December 31, 2018 and 2017, (iii) Statements of Cash Flows for years ended December 31, 2018 and 2017, (iv) Statement of Changes in Stockholders' Equity, and (v) Notes to Financial Statements.

^ Incorporated by reference to a previously filed report or document—SEC File No. 000-09587

* Management contract or compensatory plan or arrangement

Item 16. Form 10K Summary

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

ELECTRO-SENSORS, INC.	
(“Registrant”)	
By:	/s/ DAVID L. KLENK
	David L. Klenk
	President, Chief Executive Officer, and Chief Financial Officer
Date:	March 20, 2019
By:	/s/ GLORIA M. GRUNDHOEFER
	Gloria M. Grundhoefer
	Controller
Date:	March 20, 2019

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

(Power of Attorney)

Each person whose signature appears below constitutes and appoints DAVID L. KLENK as his true and lawful attorney-in-fact and agent, with full power of substitution and re-substitution, for him and in his name, place and stead, in any and all capacities, to sign any or all amendments to this Annual Report on Form 10-K and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all said attorney-in-fact and agents, or his substitute or substitutes, may lawfully do or cause to be done by virtue thereof.

Signature	Title	Date
/s/David L. Klenk	President and Director (CEO and CFO)	March 20, 2019
/s/ Joseph A. Marino	Chairman and Director	March 20, 2019

/s/ Scott A. Gabbard	Director	March 20, 2019
/s/ Michael C. Zipoy	Director	March 20, 2019
/s/ Jeffrey D. Peterson	Director	March 20, 2019