
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

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

For the quarterly period ended March 31, 2023

Or

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

For the transition period from _____ to _____

Commission File Number 000-09587

ELECTRO-SENSORS, INC.

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of incorporation or organization)

41-0943459

(IRS Employer Identification No.)

6111 Blue Circle Drive

Minnetonka, Minnesota 55343-9108

(Address of principal executive offices)

(952) 930-0100

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|--------------------------------|-------------------|---|
| Common stock, \$0.10 par value | ELSE | Nasdaq Capital Market |

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 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 ☐
Non-accelerated filer ☒

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 number of shares outstanding of the registrant's common stock, \$0.10 par value, on May 10, 2023 was 3,428,021.

ELECTRO-SENSORS, INC.
Form 10-Q
For the Period Ended March 31, 2023

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ELECTRO-SENSORS, INC. CONDENSED BALANCE SHEETS (in thousands except share and per share amounts)

| | March 31, 2023 (unaudited) | December 31, 2022 |
|--|----------------------------------|----------------------|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 5,540 | \$ 7,646 |
| Investments | 4,023 | 2,036 |
| Trade receivables, less allowance for credit losses of \$ 11 | 1,372 | 1,161 |
| Inventories | 1,779 | 1,745 |
| Other current assets | 215 | 214 |
| Income tax receivable | 0 | 11 |
| Total current assets | 12,929 | 12,813 |
| Deferred income tax asset, net | 306 | 256 |
| Property and equipment, net | 952 | 975 |
| Total assets | \$ 14,187 | \$ 14,044 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Current maturities of financing lease | \$ 4 | \$ 6 |
| Accounts payable | 357 | 274 |
| Accrued expenses | 423 | 350 |
| Accrued income taxes | 37 | 0 |
| Total current liabilities | 821 | 630 |
| Commitments and contingencies | | |
| Stockholders' equity | | |
| Common stock par value \$0.10 per share; authorized 10,000,000 shares; 3,428,021 shares issued and outstanding, respectively | 342 | 342 |
| Additional paid-in capital | 2,163 | 2,163 |
| Retained earnings | 10,864 | 10,908 |
| Accumulated other comprehensive income (loss) (unrealized income (loss) on available-for-sale securities, net of income tax) | (3) | 1 |
| Total stockholders' equity | 13,366 | 13,414 |
| Total liabilities and stockholders' equity | \$ 14,187 | \$ 14,044 |

See accompanying notes to unaudited condensed financial statements

ELECTRO-SENSORS, INC.
CONDENSED STATEMENTS OF COMPREHENSIVE LOSS
(in thousands except share and per share amounts)
(unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------------|
| | 2023 | 2022 |
| Net sales | \$ 2,045 | \$ 2,135 |
| Cost of goods sold | 1,023 | 969 |
| Gross profit | 1,022 | 1,166 |
| Operating expenses | | |
| Selling and marketing | 370 | 446 |
| General and administrative | 522 | 503 |
| Research and development | 268 | 231 |
| Total operating expenses | 1,160 | 1,180 |
| Operating loss | (138) | (14) |
| Non-operating income | | |
| Interest income | 93 | 1 |
| Total non-operating income, net | 93 | 1 |
| Loss before income tax benefit | (45) | (13) |
| Income tax benefit | (1) | (4) |
| Net loss | \$ (44) | \$ (9) |
| Other comprehensive loss | | |
| Change in unrealized value of available-for-sale securities, net of income tax | (4) | 0 |
| Other comprehensive loss | (4) | 0 |
| Net comprehensive loss | \$ (48) | \$ (9) |
| Net loss per share data: | | |
| Basic | | |
| Net loss per share | \$ (0.01) | \$ 0.00 |
| Weighted average shares | 3,428,021 | 3,395,521 |
| Diluted | | |
| Net loss per share | \$ (0.01) | \$ 0.00 |
| Weighted average shares | 3,428,021 | 3,395,521 |

See accompanying notes to unaudited condensed financial statements

ELECTRO-SENSORS, INC.
CONDENSED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(in thousands except share and per share amounts)

For the three months ended March 31

| | <u>Common Stock Issued</u> | | <u>Additional Paid-in Capital</u> | <u>Retained Earnings</u> | <u>Accumulated Other Comprehensive Income (Loss)</u> | <u>Total Stockholders' Equity</u> |
|---|----------------------------|----------------------|---|------------------------------|--|---|
| | <u>Shares</u> | <u>Amount</u> | | | | |
| December 31, 2022 | 3,428,021 | \$ 342 | \$ 2,163 | \$ 10,908 | \$ 1 | \$ 13,414 |
| Other comprehensive loss | | | | | (4) | (4) |
| Net loss | | | | (44) | | (44) |
| Balance March 31, 2023 (unaudited) | <u>3,428,021</u> | <u>\$ 342</u> | <u>\$ 2,163</u> | <u>\$ 10,864</u> | <u>\$ (3)</u> | <u>\$ 13,366</u> |
| December 31, 2021 | 3,395,521 | \$ 339 | \$ 2,041 | \$ 10,808 | \$ 0 | \$ 13,188 |
| Stock-based compensation expense | | | 1 | | | 1 |
| Net loss | | | | (9) | | (9) |
| Balance March 31, 2022 (unaudited) | <u>3,395,521</u> | <u>\$ 339</u> | <u>\$ 2,042</u> | <u>\$ 10,799</u> | <u>\$ 0</u> | <u>\$ 13,180</u> |

See accompanying notes to unaudited condensed financial statements

ELECTRO-SENSORS, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------------|
| | 2023 | 2022 |
| Cash flows used in operating activities | | |
| Net loss | \$ (44) | \$ (9) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 24 | 40 |
| Deferred income taxes | (50) | (6) |
| Stock-based compensation expense | 0 | 1 |
| Interest accrued on treasury bills | (36) | (1) |
| Change in: | | |
| Trade receivables | (211) | (150) |
| Inventories | (34) | (95) |
| Other current assets | (1) | (21) |
| Accounts payable | 83 | (23) |
| Accrued expenses | 73 | 157 |
| Income tax receivable/payable | 48 | 1 |
| Net cash used in operating activities | (148) | (106) |
| Cash flows from (used in) investing activities | | |
| Purchases of treasury bills | (3,955) | (1,999) |
| Proceeds from the maturity of treasury bills | 2,000 | 3,000 |
| Purchase of property and equipment | (1) | (3) |
| Net cash from (used in) investing activities | (1,956) | 998 |
| Cash flows used in financing activities | | |
| Payments on financing lease | (2) | (1) |
| Net cash used in financing activities | (2) | (1) |
| Net increase (decrease) in cash and cash equivalents | (2,106) | 891 |
| Cash and cash equivalents, beginning | 7,646 | 6,713 |
| Cash and cash equivalents, ending | \$ 5,540 | \$ 7,604 |
| Supplemental cash flow information | | |
| Cash paid for income taxes | \$ 0 | \$ 0 |

See accompanying notes to unaudited condensed financial statements

ELECTRO-SENSORS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MARCH 31, 2023
(in thousands except share and per share amounts)
(unaudited)

Note 1. Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions and regulations of the Securities and Exchange Commission to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

This report should be read together with the Company's Annual Report on Form 10-K for the year ended December 31, 2022, including the audited financial statements and footnotes therein.

Management believes that the unaudited financial statements include all adjustments, consisting of normal recurring accruals, necessary to fairly state the financial position and results of operations as of March 31, 2023 and for the three-month periods ended March 31, 2023 and 2022, in accordance with accounting principles generally accepted in the United States of America. The results of interim periods may not be indicative of results to be expected for the year.

Nature of Business

Electro-Sensors, Inc. (the "Company") manufactures and markets a complete line of monitoring and control systems for a wide range of industrial machine applications. The Company uses leading-edge technology to continuously improve its products, with the ultimate goal of manufacturing the industry-preferred product for each of our served markets. The Company sells these products through an internal sales staff, manufacturers' representatives, and distributors to a wide range 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.

Note 5 provides information regarding the Merger Agreement we entered into on June 10, 2022 and which was terminated January 30, 2023.

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 credit losses that reflects management's best estimate of the amounts that will not be collected. Management assesses collectability by reviewing trade receivables on a collective and individual basis. In determining the amount of the allowance for credit losses, we consider historical collectability and past due status and make judgements about the creditworthiness of customers based on ongoing credit evaluations. We also consider customer-specific information and current market conditions.

ELECTRO-SENSORS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MARCH 31, 2023
(in thousands except share and per share amounts)
(unaudited)

Revenue Recognition

At contract inception, the Company assesses the goods and services to be provided to a customer and identifies a performance obligation for each distinct good or service. We also determine the transaction price for each performance obligation at contract inception. Our contracts, generally in the form of a purchase order, specify the product or service that is to be provided 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. Certain contracts have a second performance obligation, which typically is the initialization of the HazardPRO™ product. For contracts that have multiple performance obligations, we allocate the transaction price 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 we ship the products. We recognize service revenue at the point in time when we have provided the service.

Fair Value Measurements

The carrying value of trade receivables, accounts payable, and other financial working capital items approximates fair value at March 31, 2023 and December 31, 2022, due to the short maturity nature of these instruments.

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") option pricing 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 interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option.

Use of Estimates

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

ELECTRO-SENSORS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MARCH 31, 2023
(in thousands except share and per share amounts)
(unaudited)

Net Loss per Common Share

Basic loss per share excludes dilution and is determined by dividing net loss by the weighted-average number of common shares outstanding during the period. Diluted net loss per share reflects the potential dilution that could occur if securities such as options were exercised or converted into common stock.

Diluted earnings per share ("Diluted EPS") considers the impact of potentially dilutive securities except in periods in which there is a loss because the inclusion of the potential shares would have an anti-dilutive effect. Diluted EPS also excludes the impact of common shares issuable upon the exercise of outstanding stock options in periods in which the option exercise price is greater than the average market price of our common stock during the period.

For the three-month periods ended March 31, 2023, and 2022, 300,000 and 332,500 respectively, weighted average common shares for underlying stock options have been excluded from the calculation, because their effect would be anti-dilutive.

New Accounting Standard Adopted

Accounting Standard Update ("ASU") No. 2016-13, *Financial Instruments-Credit Losses (Topic 326), Measurement of Credit Losses on Financial Statements* requires a financial asset (or a group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. ASU 2016-13 has no significant impact on our financial statements.

ELECTRO-SENSORS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MARCH 31, 2023
(in thousands except share and per share amounts)
(unaudited)

Note 2. Investments

The Company has investments in commercial paper, money market savings, Treasury Bills, and common equity securities of two private U.S. companies. The commercial paper investment is in U.S. debt with ratings of A-1+, P-1, and F1+. The Treasury Bills have remaining terms ranging from one month to three months at March 31, 2023.

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. Equity securities are stated at fair value and unrealized gains and losses, if any, are reported in our statements of comprehensive loss in non-operating income.

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

| | Cost | Gross unrealized gain | Gross unrealized loss | Fair value |
|---|-----------------|-----------------------------|-----------------------------|-----------------|
| March 31, 2023 | | | | |
| Money Market Savings | \$ 1,316 | \$ 0 | \$ 0 | \$ 1,316 |
| Treasury Bills | 7,914 | 39 | 0 | 7,953 |
| Equity Securities | 54 | 2 | 0 | 56 |
| | 9,284 | 41 | 0 | 9,325 |
| Less Cash Equivalents | 5,275 | 27 | 0 | 5,302 |
| Total Investments, March 31, 2023 | <u>\$ 4,009</u> | <u>\$ 14</u> | <u>\$ 0</u> | <u>\$ 4,023</u> |
| December 31, 2022 | | | | |
| Commercial Paper | \$ 1,377 | \$ 0 | \$ 0 | \$ 1,377 |
| Treasury Bills | 7,922 | 32 | 0 | 7,954 |
| Equity Securities | 54 | 2 | 0 | 56 |
| | 9,353 | 34 | 0 | 9,387 |
| Less Cash Equivalents | 7,319 | 32 | 0 | 7,351 |
| Total Investments, December 31, 2022 | <u>\$ 2,034</u> | <u>\$ 2</u> | <u>\$ 0</u> | <u>\$ 2,036</u> |

ELECTRO-SENSORS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MARCH 31, 2023
(in thousands except share and per share amounts)
(unaudited)

Note 3. Fair Value Measurements

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

March 31, 2023

| | Carrying amount in balance sheet | Fair Value | Fair Value Measurement Using | | |
|--|-------------------------------------|------------|------------------------------|---------|---------|
| | | | Level 1 | Level 2 | Level 3 |
| Assets: | | | | | |
| Cash equivalents | | | | | |
| Money Market Savings | \$ 1,316 | \$ 1,316 | \$ 1,316 | \$ 0 | \$ 0 |
| Treasury bills | 3,986 | 3,986 | 3,986 | 0 | 0 |
| Treasury bills - maturity date greater than three months | 3,967 | 3,967 | 3,967 | 0 | 0 |
| Equity Securities | 56 | 56 | 0 | 0 | 56 |

December 31, 2022

December 31, 2012

| | Carrying amount in balance sheet | Fair Value | Fair Value Measurement Using | | |
|--|-------------------------------------|------------|------------------------------|---------|---------|
| | | | Level 1 | Level 2 | Level 3 |
| Assets: | | | | | |
| Cash equivalents | | | | | |
| Commercial paper | \$ 1,377 | \$ 1,377 | \$ 1,377 | \$ 0 | \$ 0 |
| Treasury bills | 5,974 | 5,974 | 5,974 | 0 | 0 |
| Treasury bills - maturity date greater than three months | 1,980 | 1,980 | 1,980 | 0 | 0 |
| Equity Securities | 56 | 56 | 0 | 0 | 56 |

The fair value of the commercial paper and treasury bills is based on quoted market prices in an active market. The equity securities owned by the Company are investments in two non-publicly traded companies. There is an undeterminable market for each of these two companies and the Company has determined the fair value based on financial and other factors that are considered level 3 inputs in the fair value hierarchy.

The changes in level 3 assets measured at fair value on a recurring basis are as follows:

| | Three Months Ended March | |
|----------------------|--------------------------|--------------|
| | 31, 2023 | 2022 |
| Beginning Balance | \$ 56 | \$ 56 |
| Change in Fair Value | 0 | 0 |
| Ending Balance | <u>\$ 56</u> | <u>\$ 56</u> |

ELECTRO-SENSORS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MARCH 31, 2023
(in thousands except share and per share amounts)
(unaudited)

Note 4. Inventories

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

| | March 31, 2023 | December 31, 2022 |
|-------------------------------|-------------------|----------------------|
| Raw Materials | \$ 1,174 | \$ 1,162 |
| Work In Process | 324 | 278 |
| Finished Goods | 291 | 315 |
| Reserve for Obsolescence | (10) | (10) |
| Total Inventories, net | \$ 1,779 | \$ 1,745 |

Note 5. Merger Agreement with Mobile X Global, Inc.

On June 10, 2022, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Mobile X Newco, Inc., a Delaware corporation, a wholly owned subsidiary of the Company (the "Merger Sub"), and Mobile X Global, Inc., a Delaware corporation ("Mobile X").

On January 30, 2023, the Company and Mobile X terminated the Merger Agreement. A condition to the closing of the merger transaction was the consummation of an equity financing which the parties anticipated would be a PIPE investment (private investment in public entity). The financing necessary to consummate the merger was pursued but was not available due to difficult conditions in the financial markets, including the markets for PIPE investments.

Note 6. Contingencies

The Company sometimes becomes subject to claims against it in the ordinary course of business. There are currently no pending or threatened claims against the Company that it believes will have a material adverse effect on its results of operations or liquidity.

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

FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding our expectations, beliefs, intentions or strategies regarding the future. Forward-looking statements include, but are not limited to, statements about the success of our marketing efforts; our efforts to accelerate future growth or income; our efforts to pursue and the future outcome of any business development or other strategic alternatives; our efforts to maintain or reduce production costs; our ability to continue to obtain components and other raw materials for our products at reasonable prices as well as our ability to pass along any increased costs to our customers; our cash requirements; and the sufficiency of our cash flows or any other measure of future financial or operational performance. Any statement that is not based solely upon historical facts, including our strategies for the future and the outcome of events that have not yet occurred, is a forward-looking statement.

All forward-looking statements in this document are based on information available to us as of the date of this Form 10-Q, and we assume no obligation to update any of these forward-looking statements, other than as required by law. Our actual results could differ materially from those projected or indicated in these forward-looking statements. These forward-looking statements are subject to certain risks and uncertainties that could cause future results to differ materially from our recent results or those projected in the forward-looking statements, including the accuracy of management's assumptions with respect to industry trends, fluctuations in industry conditions, the accuracy of management's assumptions regarding expenses and our cash needs and those listed under the heading "Forward-Looking Statements" under "Item 1—Business," in our Annual Report on Form 10-K for the year ended December 31, 2022, as well as the following:

- Based on rapidly changing dynamics in global supply chains of materials and components, we may experience both price increases and difficulty in sourcing materials and components.
- We may experience changes in transportation and freight availability that may make it difficult to have materials and components shipped to us or our products shipped to customers in a timely manner.
- Supply chain dynamics may have a negative effect on the efficiency of our business operations, our customer base and the domestic or worldwide economy.
- The factors described under "Supply Chain and Labor Dynamics" in the Liquidity and Capital Resources section below.

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. These decisions include the selection of applicable accounting principles and the use of judgment in their application and affect reported amounts and disclosures. Changes in economic conditions or other business circumstances may affect the outcomes of management's estimates and assumptions. An in-depth description of our accounting estimates can be found in the interim financial statements included in this report and in our Annual Report on Form 10-K for the fiscal year ended December 31, 2022.

SELECTED FINANCIAL INFORMATION

The following table contains selected financial information, for the periods indicated, from our Condensed Statements of Comprehensive Loss expressed as a percentage of net sales.

| | Three Months Ended March 31 | |
|---|-----------------------------|--------|
| | 2023 | 2022 |
| Net sales | 100.0 % | 100.0% |
| Cost of goods sold | 50.0 | 45.4 |
| Gross profit | 50.0 | 54.6 |
| Operating expenses | | |
| Selling and marketing | 18.1 | 20.9 |
| General and administrative | 25.5 | 23.6 |
| Research and development | 13.1 | 10.8 |
| Total operating expenses | 56.7 | 55.3 |
| Operating income (loss) | (6.7) | (0.7) |
| Non-operating income | | |
| Interest income | 4.5 | 0.0 |
| Total non-operating income, net | 4.5 | 0.0 |
| Income (loss) before income tax expense (benefit) | (2.2) | (0.7) |
| Income tax expense (benefit) | 0.0 | (0.2) |
| Net income (loss) | (2.2)% | (0.5)% |

The following paragraphs discuss the Company's performance for the three months ended March 31, 2023 and 2022.

RESULTS OF OPERATIONS (in thousands)

Net Sales

Net sales for the three-month period ended March 31, 2023 were \$2,045, a decrease of \$90, or 4.2%, from \$2,135 during the comparable period in 2022. The decrease was a result of reduced domestic sales for both wired and wireless sensor products.

Gross Profit

Gross profit for the first quarter of 2023 was \$1,022, a decrease of \$144 or 12.3%, over the same period in 2022. Gross margin decreased in the first quarter of 2023 to 50.0% from 54.6% during the same period in 2022. The decrease in gross margin for the period was primarily due to an increase in material costs across all product lines.

Operating Expenses

Total operating expenses decreased \$20, or 1.7% to \$1,160 for the first quarter of 2023 compared to the same period in 2022, but increased as a percentage of net sales to 56.7% from 55.3%. The change in operating expenses was due to the following:

- Selling and marketing expenses in the first quarter of 2023 decreased \$76 to \$370, or 17.0%, from the same period in 2022 and decreased as a percentage of net sales to 18.1% from 20.9%. The decrease was primarily due to decreased sales headcount and travel expenses.
- General and administrative expenses increased \$19 to \$522, or 3.8%, in the first quarter of 2023 compared to the same period in 2022 and increased as a percentage of net sales to 25.5% from 23.6%. The increase was primarily due to expenses related to the timing of printing and mailing of our Annual Report and Proxy Statement and legal fees related to employment matters; partially offset by a decrease in legal and professional fees related to the terminated merger. The printing and mailing costs were expensed in the second quarter of 2022.
- Research and development expenses increased \$37 to \$268, or 16.0%, in the first quarter of 2023 compared to the same period in 2022 and increased as a percentage of net sales to 13.1% from 10.8%. The increase for the period was due to higher third-party engineering costs related to product development and enhancements.

Non-Operating Income

Net non-operating income increased by \$92, or 9,200.0%, for the three months ended March 31, 2023 compared to the same period in 2022. The increase is the result of additional interest income earned as a result of higher interest rates of Treasury Bills.

Loss Before Income Tax Benefit

Loss before income tax benefit was \$45 for the first quarter of 2023, representing an increase of \$32 compared to \$13 for the same period in 2022. The increase for the quarter was primarily the result of lower gross profit, partially offset by lower operating expenses, as discussed above.

Income Tax Benefit

Income tax benefit was \$1 or 0.0% of net sales in the first quarter of 2023 compared to \$4 or 0.2% of net sales in the first quarter of 2022.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were \$5,540 at March 31, 2023 and \$7,646 at December 31, 2022. The decrease was primarily the result of an increase in Treasury Bills classified as investments as of March 31, 2023 as compared to March 31, 2022. Cash, cash equivalents, and investments were \$9,563 at March 31, 2023 as compared to \$9,682 at December 31, 2022.

Cash used in operating activities was \$148 for the three months ended March 31, 2023 as compared to \$106 for the three months ended March 31, 2022. The \$42 decrease was due primarily to an increase in the net loss. The 2023 net loss compared to the 2022 net loss was primarily due to decreased gross profit.

Cash used in investing activities was \$1,956 for the three months ended March 31, 2023 compared to cash from investing activities of \$998 for the three months ended March 31, 2022. The increase was due to an increase in Treasury Bill purchases as compared to maturities of Treasury Bills classified as investments.

Cash used in financing activities in the three months ended March 31, 2023 was \$2 as compared to \$1 for the three months ended March 31, 2022.

Subject to the following section, entitled "Supply Chain and Labor Dynamics," the Company believes its ongoing cash requirements will be primarily for capital expenditures, research and development, working capital, corporate and business development and other strategic alternatives and that existing cash, cash equivalents, and investments and any cash generated from operations will be sufficient to meet these cash requirements through at least the next 12 months.

Supply Chain and Labor Dynamics

We traditionally have had one or more robust sources for production components and materials. However, we continue to experience disruptions in our supply chain, resulting in difficulty sourcing some components. We are also experiencing price increases for many of the components used in our products. To meet these challenges we are modifying product designs to accommodate new components that are more readily available at competitive prices. There is no guarantee that we will continue to be successful in modifying these designs and sourcing alternative components. As a result, we could experience significant delays in receiving certain components needed to make timely customer deliveries, as well as increased costs that erode gross margins. Furthermore, the labor market for qualified employees able to fill our production positions is challenging and may result in delays in filling open positions. While we continue to closely manage each of these activities, our actions may not be successful and may result in a negative effect on our sales and profit margins.

Future Corporate and 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 or business acquisitions. In addition, we continue to explore other strategic investments that we believe present good opportunities for the Company and its shareholders. On June 13, 2022, we announced that we had entered into a Merger Agreement with Mobile X Newco, Inc. and Mobile X Global, Inc. On January 30, 2023, we announced that the Merger Agreement had been terminated and that the Company's Board of Directors had established a special committee to explore and pursue business development and other strategic alternatives.

Off-balance Sheet Arrangements

As of March 31, 2023, the Company had no off-balance sheet arrangements or transactions.

Non-GAAP Financial Measure

In addition to financial results reported in accordance with accounting principles generally accepted in the United States of America ("GAAP"), the Company is providing a non-GAAP financial measure in this Form 10-Q and an itemized reconciliation between Net Loss, a GAAP financial measure, and Adjusted Net Income (Loss), the non-GAAP financial measure.

The Company is using "Adjusted Net Income (Loss)" as a non-GAAP financial measure to facilitate period-to-period comparisons and analysis of its operating performance and believes it is useful to investors as a supplement to GAAP measures in analyzing, trending and benchmarking the performance and value of the Company's business. This measure is not intended to be a substitute for, or more meaningful than, Net Loss in accordance with GAAP, but is provided as supplemental information. This measure may be different from Adjusted Net Income (Loss) or similar financial measures used by other companies, even when similar terms are used to identify these measures.

As discussed below, to calculate Adjusted Net Income (Loss), the Company added back the costs and expenses, less estimated taxes, related to the negotiation and execution of the June 10, 2022 proposed Mobile X merger transaction to Net Loss for the three months ended March 31, 2023 and 2022. The Company believes adding back these costs and expenses more accurately portrays the underlying results and trends of the ongoing business.

These expenses continued throughout the first quarter of 2023. On January 30, 2023, the Company and Mobile X jointly agreed to terminate the merger agreement. Although the costs and expenses related to the Company-Mobile X Merger Agreement were incurred primarily in general and administrative expenses, the Company is not presenting any other non-GAAP information because it believes it has adequately set forth these expenses in the Management's Discussion and Analysis section of this Form 10-Q.

The Company incurred approximately \$18 and \$95 in legal and other professional fees for the three months ended March 31, 2023 and 2022, respectively, related to the Mobile X merger opportunity. The following table sets forth a reconciliation of Net Loss, a GAAP financial measure, to Adjusted Net Income (Loss) (as defined above), the non-GAAP measure, for the periods noted.

| | Three Months Ended March 31 | |
|--------------------------------------|-----------------------------|--------------|
| | 2023 | 2022 |
| Net Loss - GAAP | \$ (44) | \$ (9) |
| Plus merger related expenses | 18 | 95 |
| Less income taxes on merger expenses | (4) | (20) |
| Adjusted Net Income (Loss) | <u>\$ (30)</u> | <u>\$ 66</u> |

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not Applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation with the participation of the Company's management, the Company's principal executive officer and principal financial officer has concluded that the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act"), were effective as of March 31, 2023.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the first quarter of 2023 that 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.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings – None

Item 1A. Risk Factors – Not Applicable

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

Item 3. Defaults Upon Senior Securities – None

Item 4. Mine Safety Disclosures – Not Applicable

Item 5. Other Information – None

Item 6. Exhibits

| Exhibit | Description |
|-----------------------------|--|
| <u>31.1</u> | <u>Certification of CEO and CFO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u> |
| <u>32.1</u> | <u>Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| 101 | The following financial information from Electro-Sensors, Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2023, formatted in iXBRL (Inline Extensible Business Reporting Language), (i) Condensed Balance Sheets as of March 31, 2023 and December 31, 2022, (ii) Condensed Statements of Comprehensive Loss for the three months ended March 31, 2023 and March 31, 2022 (iii) Condensed Statements of Changes in Stockholders' Equity for the three months ended March 31, 2023 and March 31, 2022, (iv) Condensed Statements of Cash Flows for the three months ended March 31, 2023 and March 31, 2022, and (v) Notes to Financial Statements. |

SIGNATURES

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

Electro-Sensors, Inc.

May 11, 2023

/s/ David L. Klenk

David L. Klenk
Chief Executive Officer and Chief Financial Officer
(Principal Executive Officer and Principal Financial Officer)

**CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES OXLEY-ACT OF 2002**

I, David L. Klenk, certify that:

1. I have reviewed this report on Form 10-Q of Electro-Sensors, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under my supervision, to ensure that material information relating to the registrant is made known to me by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under my supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report my conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 11, 2023

/s/ David L. Klenk
David L. Klenk
Chief Executive Officer and Chief Financial Officer

**CERTIFICATION PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Electro-Sensors, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2023 as filed with the Securities and Exchange Commission (the "Report"), I, David L. Klenk, Chief Executive Officer and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

May 11, 2023

/s/ David L. Klenk
David L. Klenk
Chief Executive Officer and Chief Financial Officer