VioQuest Pharmaceuticals, Inc.
Form 424B3
November 15, 2007

Filed Pursuant to Rule 424(b)(3)
Registration No. 333-138782

Prospectus Supplement No. 3
(to Prospectus dated April 13, 2007)

This Prospectus Supplement No. 3 supplements and amends the prospectus dated April 13, 2007, or the Original Prospectus, and the other Prospectus Supplements thereto, dated May 15, 2007, and August 8, 2007, which we refer to collectively as the Prospectus. The Prospectus relates to the sale from time to time of up to 47,798,626 shares of common stock of VioQuest Pharmaceuticals, Inc., by certain selling stockholders, including 12,746,612 shares issuable upon the exercise of outstanding warrants. We will not receive any of the proceeds from the sale of shares by the selling stockholders. We will receive proceeds from any cash exercise of warrants by the selling stockholders.

On November 14, 2007, we filed with the Securities and Exchange Commission our Quarterly Report on Form 10-QSB for the quarter ended September 30, 2007, a copy of which is attached (although the exhibits to such report have been omitted). The information set forth on the attachment supplements and amends the information contained in the Prospectus.

This Prospectus Supplement No. 3 should be read in conjunction with, and delivered with, the Prospectus and is qualified by reference to the Prospectus except to the extent that the information in this Prospectus Supplement No. 3 supersedes the information contained in the Prospectus.

Our common stock is quoted on the Over-the-Counter Bulletin Board under the symbol “VQPH.” On November 14, 2007, the last sale price for our common stock as reported on the OTC Bulletin Board was $0.27.

Investing in our common stock involves risk. See “Risk Factors” beginning on page 4 of the Original Prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if the Prospectus or this Prospectus Supplement No. 3 is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this Prospectus Supplement No. 3 is November 14, 2007.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2007

OR

o TRANSITION REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _______ to _______

Commission File Number 0-16686

VIOQUEST PHARMACEUTICALS, INC.

(Exact name of small business issuer as specified in its charter)

Delaware	58-1486040
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

180 Mount Airy Road, Suite 102, Basking Ridge, New Jersey 07920
(Address of Principal Executive Offices)

(908) 766-4400
(Issuer's telephone number, including area code)

(Former name, former address and former fiscal year, if changed from last report)

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

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

As of November 14, 2007 there were 54,621,119 shares of the issuer's common stock, $0.001 par value, outstanding.

Traditional Small Business Disclosure Format (check one): Yes o No x

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Forward-Looking Statements

This Quarterly Report on Form 10-QSB contains statements that are not historical, but are forward-looking in nature, including statements regarding the expectations, beliefs, intentions or strategies regarding the future. In particular, the "Management's Discussion and Analysis or Plan of Operations" section in Part I, Item 2 of this quarterly report includes forward-looking statements that reflect our current views with respect to future events and financial performance. We use words such as we "expect," "plan," "anticipate," "believe," "intend" and similar expressions to identify forward-looking statements. A number of important factors could, individually or in the aggregate, cause actual results to differ materially from those expressed or implied in any forward-looking statements. Such factors include, but are not limited to, the following:

- the possibility that the results of clinical trials will not be successful;
- the possibility that our development efforts relating to our product candidates, including Lenocta™, VQD-002 and Xyfid™, will not be successful;
- the inability to obtain regulatory approval of our product candidates;
- our reliance on third-parties to develop our product candidates;
- our lack of experience in developing and commercializing pharmaceutical products;
- the possibility that our licenses to develop and commercialize our product candidates may be terminated;
- our ability to obtain additional financing;
- our ability to protect our proprietary technology.

Other risks are described under the section entitled "Risk Factors" following Item 1 in Part I of our Annual Report on Form 10-KSB for the year ended December 31, 2006.

PART I - FINANCIAL INFORMATION

Item 1. Unaudited Condensed Consolidated Financial Statements.

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF SEPTEMBER 30, 2007 (UNAUDITED) AND DECEMBER 31, 2006

	September 30, 2007 (Unaudited)	December 31, 2006 (Note 1A)
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 2,456,639	$ 2,931,265
Prepaid clinical research costs	299,960	273,172
Deferred financing costs	536,371	-
Other current assets	111,011	168,841
Current assets associated with discontinued operations	-	2,396,435
Total Current Assets	3,403,981	5,769,713
PROPERTY AND EQUIPMENT, NET	37,466	43,378
SECURITY DEPOSITS	15,232	15,232
TOTAL ASSETS	$ 3,456,679	$ 5,828,323
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)		
CURRENT LIABILITIES		
Accounts payable	$ 2,032,514	$ 1,031,458
Accrued compensation and related taxes	299,434	245,475
Other accrued expenses	708,462	180,440
Note payable - Paramount BioSciences, LLC	-	264,623
Convertible notes, net of unamortized debt discount of $1,223,451	2,550,549	-
Current liabilities associated with discontinued operations	-	1,265,568
TOTAL LIABILITIES	5,590,959	2,987,564
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY (DEFICIENCY)		
Preferred stock; $0.001 par value: 10,000,000 shares authorized, 0 shares issued and outstanding at September 30, 2007 and December 31, 2006	-	-
Common stock; $0.001 par value: 100,000,000 shares authorized at September 30, 2007 and December 31, 2006, 54,621,119 shares issued and outstanding at September 30, 2007 and December 31, 2006	54,621	54,621
Additional paid-in capital	34,223,939	31,326,694
Accumulated deficit	(36,412,840)	(28,540,556)
Total Stockholders' Equity (Deficiency)	(2,134,280)	2,840,759
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIENCY)	$ 3,456,679	$ 5,828,323

See accompanying notes to condensed consolidated financial statements.

VIOQUEST PHARMACEUTICALS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2007 AND 2006
(UNAUDITED)

	For the Three Months Ended September 30, 2007	For the Three Months Ended September 30, 2006	For the Nine Months Ended September 30, 2007	For the Nine Months Ended September 30, 2006
OPERATING EXPENSES				
Research and development	$ 1,473,937	$ 273,876	$ 3,793,592	$ 933,599
Selling, general and administrative	1,199,182	673,495	3,305,232	2,348,030
Total Operating Expenses	2,673,119	947,371	7,098,824	3,281,629
LOSS FROM OPERATIONS	(2,673,119)	(947,371)	(7,098,824)	(3,281,629)
INTEREST (EXPENSE) / INCOME, NET	(542,360)	36,246	(510,285)	85,361
LOSS FROM CONTINUING OPERATIONS	(3,215,479)	(911,125)	(7,609,109)	(3,196,268)
DISCONTINUED OPERATIONS				

of property and equipment	**(45)**	(18)
Net cash from (used in) investing activities	**(739)**	343
Cash flows from (used in) financing activities		
Proceeds from issuances of common stock	**4**	8
Dividends paid	**0**	(272)
Net cash from (used in) financing activities	**4**	(264)
Net increase (decrease) in cash and cash equivalents	**(618)**	14
Cash and cash equivalents, beginning	**1,505**	1,102
Cash and cash equivalents, ending	**$ 887**	$ 1,116
Supplemental cash flow information		
Cash paid for income taxes	**$ 462**	$ 524
Supplemental disclosure of non-cash investment and financing activities		
Note payable issued to fund acquisition, net of discount	**$ 771**	$ 0
Contingent consideration recorded in connection with the acquisition	**$ 472**	$ 0

See accompanying notes to unaudited consolidated financial statements

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ELECTRO-SENSORS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(in thousands except share and per share amounts)
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Note 1. Basis of Presentation

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

This report should be read together with the Company s Annual Report on Form 10-K for the year ended December 31, 2013, including the audited financial statements and footnotes therein.

It is the opinion of management that the unaudited consolidated financial statements include all adjustments, consisting of normal recurring accruals, necessary to fairly state the financial position and results of operations as of September 30, 2014 and for the three and nine-month periods then ended 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

The accompanying consolidated financial statements include the accounts of Electro-Sensors, Inc. and its wholly-owned subsidiaries, ESI Investment Company and Senstar Corporation. Senstar has no operations. Intercompany accounts, transactions and earnings have been eliminated in consolidation. The consolidated entity is referred to as the Company.

Electro-Sensors, Inc. manufactures and markets a complete line of monitoring and motor control systems for a variety of industrial machinery. The Company uses leading-edge technology to continuously improve its products and make them easier to use with the ultimate goal of manufacturing the industry-preferred product for every market served. These products are sold through an internal sales staff, manufacturer s representatives, and distributors to a wide variety of manufacturers and processors who use the products to monitor process machinery operations. The Company markets its products to a variety of industries located throughout the United States, Canada, Latin America, Europe, and Asia.

In addition, through its subsidiary ESI Investment Company, the Company periodically makes strategic investments in other businesses, primarily when the Company believes that these investments will facilitate development of technology complementary to the Company s products. Although the Company, through ESI Investment Company, invests in other businesses, the Company does not intend to become an investment company and intends to remain primarily an operating company. The Company s primary investment is 138,217 shares of Rudolph Technologies, Inc. (Rudolph) which the Company accounts for using the available-for-sale method. See Note 4 for additional information regarding the Company s investments. The Company s investments in securities are subject to normal market risks.

Revenue Recognition

The Company recognizes revenue from the sale of its production monitoring equipment when persuasive evidence of an arrangement exists, the product has been picked up by common carrier, the fee is fixed and determinable and collection of the resulting receivable is reasonably assured. The Company recognizes revenue upon shipment because the contracts do not include post-shipment obligations. The Company may offer discounts that are recorded at the time of sale. In addition to exchanges and warranty returns, customers have limited refund rights. Historically, returns have been minimal and immaterial to the consolidated financial statements and are generally recognized when the returned product is received by the Company. In some situations, the Company receives advance payments from its customers. Revenue associated with these advance payments is deferred until the product is shipped.

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Available-for-Sale Securities

The Company s investments consist of equity securities, primarily common stocks and government debt securities. The estimated fair value of publicly traded equity securities is based on quoted market prices, and therefore subject to the inherent risk of market fluctuations.

Management determines the appropriate classification of securities at the date individual investments are acquired, and evaluates the appropriateness of each classification at each balance sheet date.

Since the Company generally does not make investments in anticipation of short-term fluctuations in market prices, investments in equity securities and treasury bills are classified as available-for-sale. Available-for-sale securities with readily determinable values are stated at fair value, and unrealized holding gains and losses, net of the related deferred tax effect, are reported as a separate component of stockholders equity.

Realized gains and losses on securities, including losses from declines in value of specific securities determined by management to be other-than-temporary, are included in the period realized. There were no other-than-temporary impairments in either of the nine-month periods ended September 30, 2014 and 2013.

Fair Value Measurements

The Company s policies incorporate the guidance for accounting for fair value measurements of financial assets and financial liabilities and for fair value measurements of nonfinancial items that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. These policies also incorporate the guidance for fair value measurement related to nonfinancial items that are recognized and disclosed at fair value in the consolidated financial statements on a nonrecurring basis. The guidance establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.
Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair measurement in its entirety falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The carrying values of cash equivalents, treasury bills, commercial paper, money market funds, trade receivables, accounts payable, and other working capital items approximate fair value at September 30, 2014 and December 31, 2013 due to the short maturity nature of these instruments.

Stock Based Compensation

The Company uses the straight-line method to recognize compensation expense based on the fair value on the date of grant over the requisite service period required for each award to vest. The fair value of stock options is estimated using the Black-Sholes-Merton (BSM) option pricing model, which incorporates certain assumptions, such as risk-free interest rate, expected volatility, expected dividend yield, and expected life of options.

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Income Taxes

Deferred income taxes are presented as assets or liabilities based on timing differences between financial reporting and tax reporting methods. The Company computes deferred income tax assets and liabilities, and reports differences that have future tax consequences using the currently enacted tax laws and rates that apply to the periods in which the Company expects these income tax assets and liabilities to affect taxable income. Income tax expense (benefit) is the current tax payable or refundable for the period plus or minus the net change in the deferred tax assets and liabilities, excluding the portion of the deferred liability allocated to other comprehensive income. Deferred tax assets are reduced by a valuation allowance to the extent that realization of the related deferred tax asset is not assured. No valuation allowance was deemed necessary at September 30, 2014 and December 31, 2013.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates, including the underlying assumptions, consist of economic lives of property and equipment, the determination of fair value of acquired tangible and intangible assets, realizability of accounts receivable, valuation of deferred tax assets/liabilities, inventories, investments, contingent earn-out, and stock compensation expense. It is at least reasonably possible that these estimates may change in the near term.

Note 2. Business Combination

On February 18, 2014, the Company acquired Harvest Engineering, Inc. s wireless hazard monitoring technology and Insta-Link product family, together with related technology and intellectual property rights, for a total purchase price of $1,643.

The fair value of the consideration transferred on the acquisition date consisted of the following:

Cash consideration	$	400
Note payable issued to seller (Note 9)		771
Contingent earn-out liability		472
Total consideration	$	1,643

The transaction was recorded as a business combination and the results of operations have been included in the consolidated statement of comprehensive income (loss) since the date of acquisition. Acquisition fees of approximately $15 incurred in connection with the transaction were recorded in operating expenses for the nine months ended September 30, 2014.

In connection with the acquisition, the Company is obligated to pay an earn-out of up to $550 based upon the level of revenues generated from the acquired products during the four calendar years following closing. The Company currently has recorded a liability of $472 related to this obligation. This contingent liability represents the fair value estimate of the earn-out based upon the Company s projected likelihood of meeting the revenue targets.

The following table summarizes the estimated fair values of the assets acquired at the acquisition date:

In process research and development	$	1,478
Not-to-compete agreement		120
Deferred service costs		45
Total assets acquired	$	1,643

The not-to-compete agreement is being amortized over a five-year period. The fair value of the not-to-compete agreement was estimated using a discounted cash flow model. The unobservable inputs are considered Level 3 inputs in the fair value hierarchy.

The Company has not presented pro forma results of operations for the current acquisition because the acquisition is not material to the Company s consolidated results of operations, financial position or cash flows.

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Note 3. Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted average number of common shares outstanding and common stock equivalents outstanding during the period.

Note 4. Investments

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

	Cost	Gross unrealized gain	Gross unrealized loss	Fair value
September 30, 2014				
Money Market	$ 353	$ 0	$ 0	$ 353
Commercial Paper	345	0	0	345
Treasury Bills	6,543	0	0	6,543
Equity Securities	74	1,233	(55)	1,252
	7,315	1,233	(55)	8,493
Less Cash Equivalents	698	0	0	698
Total Investments, September 30, 2014	$ 6,617	$ 1,233	$ (55)	$ 7,795
December 31, 2013				
Money Market	$ 540	$ 0	$ 0	$ 540
Commercial Paper	601	0	0	601
Treasury Bills	5,226	1	0	5,227
Equity Securities	86	2,686	(54)	2,718
	6,453	2,687	(54)	9,086
Less Cash Equivalents	1,141	0	0	1,141
Total Investments, December 31, 2013	$ 5,312	$ 2,687	$ (54)	$ 7,945

At September 30, 2014 and December 31, 2013, the Company s significant investment in equity securities was 138,217 and 231,336 shares, respectively, of Rudolph, accounted for under the available-for-sale method. As of September 30, 2014 and December 31, 2013, the aggregate value of the Company s Rudolph shares as reported on the Nasdaq Stock Exchange (ticker symbol RTEC) was approximately $1,251 and $2,716, respectively, with an approximate cost of $18 and $30, respectively. During the three-month periods ended September 30, 2014 and 2013, the Company sold 25,700 and 10,000 shares, respectively, of Rudolph stock and reported gains of $258 and $129, respectively, in non-operating income. During the nine-month periods ended September 30, 2014 and 2013, the Company sold 93,119 and 41,931 shares, respectively, of Rudolph stock and reported gains of $1,008 and $529, respectively, in non-operating income.

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Note 5. Fair Value Measurements

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

September 30, 2014

	Carrying amount in consolidated balance sheet	Fair Value	Fair Value Measurement Using Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents					
Money Market	$ 353	$ 353	$ 353	$ 0	$ 0
Commercial Paper	345	345	345	0	0
Treasury Bills	6,543	6,543	6,543	0	0
Available for sale:					
Equities:					
Small Cap Technology Sector	1,252	1,252	1,252	0	0
Liabilities:					
Contingent Earn-out	472	472	0	0	472

December 31, 2013

	Carrying amount in consolidated balance sheet	Fair Value	Fair Value Measurement Using Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents					
Money Market	$ 540	$ 540	$ 540	$ 0	$ 0
Commercial Paper	601	601	601	0	0
Treasury Bills	5,227	5,227	5,227	0	0
Available for sale:					
Equities:					
Small Cap Technology Sector	2,718	2,718	2,718	0	0

The fair value of the money market funds, commercial paper, and treasury bills is based on quoted market prices in an active market. Available-for-sale securities include equity securities that are traded in an active market. Closing stock prices are readily available from active markets and are used as being representative of fair value. The Company classifies these securities as level 1. Management estimated the probability of meeting the revenue targets over the measurement period to determine the fair value of the contingent payable, which is considered a level 3 input in the fair value hierarchy.

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

Balance at December 31, 2013	$ 0
Additions (Note 2)	472
Balance at September 30, 2014	$ 472

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Note 6. Inventories

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

	September 30, 2014	December 31, 2013
Raw Materials	**$ 797**	$ 658
Work In Process	**263**	226
Finished Goods	**205**	176
Total Inventories	**$ 1,265**	**$** 1,060

Note 7. Property and Equipment

The following is a summary of property and equipment:

	September 30, 2014	December 31, 2013
Equipment	**$ 266**	$ 272
Furniture & Fixtures	**380**	388
Building	**1,365**	1,365
Land	**415**	415
	2,426	2,440
Less Accumulated Depreciation	**1,251**	1,223
Total Property and Equipment	**$ 1,175**	$ 1,217

Note 8. Net Intangible Assets

Our intangible assets are comprised of a Not-to-Compete and the HazardPRO™ technology. The Not-to-Compete is being amortized over five years and the HazardPRO™ technology is being amortized over seven years, in both cases on a straight-line basis.

	September 30, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Not-to-Compete	$ 120	$ 16	$ 104
Technology	1,478	18	1,460
Net Intangible Assets	$ 1,598	$ 34	$ 1,564

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Note 9. Note Payable

The note payable consists of the following at September 30, 2014:

Note Payable	$	800
Payable in two annual installments of principal of $400 with a maturity date of February 2016. This note is non-interest bearing and unsecured.		
Less: Discount of debt instrument listed above		(29)
Net Note Payable		771
Less: Current Maturities		381
Note Payable Long Term	$	390

Scheduled maturities of the note payable are as follows at September 30, 2014

October 1, 2014 to September 30, 2015	$	381
October 1, 2015 to September 30, 2016		390
Total	$	771

Note 10. 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 BSM model with the assumptions included in the table below. 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. The Company calculates expected volatility for stock options and awards using historical volatility because the Company believes the future volatility will approximate historical volatility. At September 30, 2014, the Company had one active stock-based employee compensation plan.

During the second quarter of 2014, the Company granted one director options to purchase 25,000 shares of common stock. The options were priced above 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 ten years from the date of grant.

During the third quarter of 2013, the Company granted to its Chief Executive Officer and three of its outside directors options to each purchase 50,000 shares of common stock and granted options to purchase 25,000 shares of common stock to the fourth outside director. The options to the Chief Executive Officer were granted at fair market value and vested immediately. The options granted to outside directors were priced above fair market value and vested 20% on the grant date, with an additional 20% vesting on the first four anniversaries of the grant date. All of the stock option grants expire ten years from the date of the grant.

The assumptions made in estimating the fair value of the options on the grant date based upon the BSM option-pricing model are as follows:

	Nine Months Ended September 30	
	2014	**2013**
Dividend Yield	0.00%	0.00%
Expected Volatility	44.11%	44.27-45.00%
Risk Free Interest Rate	2.02%	1.33-1.92%
Expected Life	6 Years	5.5-6 Years

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The Company recognized compensation expense of approximately $51 and $149 during the nine months ended September 30, 2014 and 2013, respectively, in connection with the issuance of the options.

There were no stock options exercised during the nine-month period ended September 30, 2014. During the nine-month period ended September 30, 2014, 14,480 stock options outstanding were forfeited.

A summary of the Company s stock option plan as of September 30, 2014 and changes during the nine months then ended is listed below:

	Number of Shares		Weighted-Average Exercise Price
Balance at January 1, 2014	246,980	$	4.53
Granted	25,000		4.39
Exercised	0		
Canceled/forfeited/expired	14,480		4.16
Balance at September 30, 2014	257,500	$	4.54
Vested and exercisable as of September 30, 2014	132,500		

The Company has two equity plans with options outstanding. This roll forward includes both plans.

As of September 30, 2014, there was approximately $188 of unrecognized compensation expense. The Company expects to recognize this expense over the next four years. There was no intrinsic value in the options outstanding or exercisable as of September 30, 2014 as all exercise prices were greater than the current fair market value as of that date.

Note 11. Segment Information

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

The accounting policies of the segments are described in Note 1 of the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013. In evaluating segment performance, management focuses on sales and income before taxes. The Company has no inter-segment sales.

The following is financial information relating to the continuing operating segments:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2014		2013		2014		2013	
External sales								
Production monitoring	**$**	**1,917**	$	1,708	**$**	**5,379**	$	4,813
Total	**$**	**1,917**	$	1,708	**$**	**5,379**	$	4,813
Income before income taxes								
Production monitoring	**$**	**223**	$	18	**$**	**397**	$	220
Investments		**258**		132		**1,010**		534
Total	**$**	**481**	$	150	**$**	**1,407**	$	754

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

CRITICAL ACCOUNTING ESTIMATES

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make decisions based upon estimates, assumptions, and factors it considers relevant to the circumstances. These decisions include the selection of applicable accounting principles and the use of judgment in their application, the results of which 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, 2013. New estimates for the allocation of the purchase price for acquired tangible and intangible assets and the contingent earn-out have been added to the estimates discussed in our Annual Report.

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

	Three Months Ended September 30		Nine Months Ended September 30	
	2014	**2013**	**2014**	**2013**
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	40.2	42.6	41.8	42.4
Gross profit	59.8	57.4	58.2	57.6
Operating expenses:				
Selling and marketing	21.3	22.1	22.3	24.2
General and administrative	17.1	26.0	18.0	21.3
Research and development	9.7	8.4	10.5	7.8
Total operating expenses	48.1	56.5	50.8	53.3
Operating income	11.7	0.9	7.4	4.3
Non-operating income (expense):				
Interest expense	(0.3)	0.0	(0.2)	0.0
Gain on sale of available-for-sale securities	13.5	7.5	18.7	11.0
Interest income	0.0	0.2	0.0	0.1
Other income	0.2	0.2	0.2	0.2
Total non-operating income	13.4	7.9	18.7	11.3
Income before income taxes	25.1	8.8	26.1	15.6
Provision for income taxes	8.8	2.7	9.1	4.4
Net income	16.3%	6.1%	17.0%	11.2%

The following discusses the Company s performance for the three and nine months ended September 30, 2014 and 2013.

RESULTS OF OPERATIONS

Net Sales

Net sales for the three-month period ended September 30, 2014 increased $209,000, or 12.2%, when compared to the same period in 2013. Net sales for the nine-month period ended September 30, 2014 increased $566,000, or 11.8%, when compared to the same period in 2013. The increase in both periods was primarily due to strong performance in our central U.S. regions, which increased 37.3% and 20.9% in the respective three-month and nine-month periods, compared to the same 2013 periods. In the 2014 third quarter, we also experienced strong performance in the grain, feed, and milling market segments, which we believe was a result of facility expansion and plant upgrades in anticipation of large harvest volumes of corn and soybeans.

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Consistent with our prior disclosures, we continue to integrate and deploy the HazardPRO™ wireless hazard monitoring technology acquired earlier in 2014 and continue to believe these products will be accretive to our quarterly earnings per share beginning in the 2015 second quarter.

Gross Margin

Gross margin for the three-month period ended September 30, 2014 was 59.8% versus 57.4% for the same period in 2013. For the nine-month periods ended September 30, 2014 and 2013, gross margins were 58.2% and 57.6%, respectively. The increase in gross margin, for both periods, was primarily due to a change in the mix of products sold. We continue our efforts to maintain or increase gross margin by designing and manufacturing products in the most cost effective manner.

Operating Expenses

Total operating expenses decreased $44,000, or 4.6%, for the three months ended September 30, 2014 when compared to the same period in 2013. Operating expenses for the nine months ended September 30, 2014 increased $172,000, or 6.7% compared to the same 2013 period. As a percentage of revenue, however, operating expenses decreased to 48.1% in the 2014 three-month period compared to 56.5% in the same period for 2013 and decreased to 50.8% in the 2014 nine-month period compared to 53.3% for the same period in 2013.

Selling and marketing costs increased $31,000, or 8.2%, for the three months ended September 30, 2014 when compared to the same period in 2013. For the nine months ended September 30, 2014, selling and marketing costs increased $34,000, or 2.9%, over the same period in 2013. The increase for both the three- and nine-month periods was due to both higher sales compensation due to increased sales and to higher travel expenses.

General and administrative costs decreased $117,000, or 26.4%, for the three months ended September 30, 2014 compared to the same period in 2013. For the nine months ended September 30, 2014, general and administrative costs decreased $55,000, or 5.4%, when compared to the same period in 2013. The decrease in the three-month period was primarily due to a decrease of approximately $133,000 of noncash stock compensation expense related to stock options granted during the 2013 third quarter. This decrease was partially offset by increases in depreciation and amortization and expenses related to developing post-closing deliverables, which are both related to the technology purchased in February 2014. The decrease in the nine-month period was primarily due to a decrease of approximately of $98,000 of noncash stock compensation expense related to stock options granted during the 2013 third quarter. The decrease was partially offset by increases in depreciation and amortization and expenses related to developing post-closing deliverables, which are both related to the technology purchased in February 2014, and insurance expense due to a new director and officer liability insurance policy.

Research and development costs for the three months ended September 30, 2014 increased $42,000, or 29.2%, compared to the same period in 2013. For the nine months ended September 30, 2014, research and development costs increased $193,000, or 51.6%, when compared to the same period in 2013. For the three months ended September 30, 2014, the increase was due to development of new prototypes and an increase in wages and benefits due to changes in management responsibilities. For the nine months ended September 30, 2014, the increase resulted from an increase in wages and benefits due to changes in management responsibilities, lab testing fees for product approval for hazardous location and development of new prototypes.

Non-Operating Income

Non-operating income increased by $121,000, or 89.6%, for the three-month period ended September 30, 2014 compared to the same period for 2013. For the nine months ended September 30, 2014, non-operating income increased $463,000, or 84.8%, when compared to the same period in 2013. The increase for the 2014 three- and nine-month periods is due to a higher number of shares of Rudolph Technologies, Inc. (Rudolph) stock sold, partially offset by an increase in interest expense. During the three months ended September 30, 2014 and 2013, we sold 25,700 and 10,000 shares, respectively, of Rudolph stock and recognized gains of $258,000 and $129,000, respectively, on the sales. During the nine months ended September 30, 2014 and 2013, we sold 93,119 and 41,931 shares, respectively, of Rudolph stock and recognized gains of $1,008,000 and $529,000, respectively, on the sales. During the three and nine months ended September 30, 2014, we recognized $5,000 and $12,000, respectively, of interest expense related to our 2014 technology acquisition.

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Income Before Income Taxes

Income before income taxes was $481,000 for the three months ended September 30, 2014, representing an increase of $331,000, or 220.7%, when compared to the same period in 2013. Income before income taxes was $1,407,000 for the nine months ended September 30, 2014, representing an increase of $653,000, or 86.6%, when compared to the same period in 2013.

The Production Monitoring Division had income before income taxes of $223,000 for the three months ended September 30, 2014 compared to $18,000 for the same period in 2013, an increase of $205,000, or 1138.9%. For the nine months ended September 30, 2014, the Production Monitoring Division had income before income taxes of $397,000 compared to $220,000 for the same period in 2013, an increase of $177,000, or 80.5%. The increase in income before income taxes for the three and nine months ended September 30, 2014 was due to the increase in sales, higher gross profits, and lower operating costs as a percentage of sales than in the 2013 periods. (See Operating Expenses).

ESI Investment Company had income before income taxes of $258,000 for the three-month period ended September 30, 2014 compared to $132,000 for the same period in 2013, an increase of $126,000, or 95.5%. ESI Investment Company had income before income taxes of $1,010,000 for the nine-month period ended September 30, 2014 compared to income before income taxes of $534,000 for the same period in 2013, an increase of $476,000, or 89.1%. These increases were a result of the greater gain on the sales of available-for-sale securities in 2014 compared to 2013 (see Non-Operating Income).

The net decrease in the unrealized value of available-for-sale securities was $227,000 and $901,000 for the three and nine months, respectively, ended September 30, 2014. The net decrease is due to the sale of Rudolph stock, which resulted in a $258,000 and $1,008,000 gain on the sales, and the decrease in the market price of Rudolph during the three and nine months, respectively, ended September 30, 2014. ESI Investment Company has approximately $1,233,000 in unrealized gain on the Rudolph investment that is reported in Other Comprehensive Income (see Note 4 Investments in the notes to the accompanying consolidated financial statements).

Provision for Income Taxes

Income taxes for the three-month periods increased from $46,000 in 2013 to $168,000 in 2014 and for the nine-month periods increased from $214,000 in 2013 to $492,000 in 2014, reflecting higher income in both 2014 periods. Income taxes increased as a percentage of sales because of significant gains on sale of available-for-sale securities.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents were $887,000 at September 30, 2014 and $1,505,000 at December 31, 2013.

Cash from operating activities was $117,000 for the nine months ended September 30, 2014, compared to cash used in operating activities of $65,000 for the nine months ended September 30, 2013. Cash from operating activities increased $182,000 for the nine months ended September 30, 2014 when compared to the same period in 2013, mainly due to the net change in accounts payable and accrued income taxes, partially offset by the net change in inventories and the decrease in net income, adjusted for the gain on sales of available-for-sale securities. The net change in accounts payable was due to the timing of inventory purchases. The net change in income taxes was due to an increase in the payable balance of $44,000 at September 30, 2014 when compared to the prior year and a decrease in the payable of $289,000 at September 30, 2013 when compared to the prior year. The 2014 payable increase resulted from the increase in operating income and the gain on sales of available-for-sale securities when comparing 2014 to 2013. The Company paid the 2012 tax year balance due in March 2013. The net change in inventories was due to increased 2014 sales and the purchase of HazardPRO™ components.

Cash used in investing activities was $739,000 compared to cash generated from investing activities of $343,000 for the nine months ended September 30, 2014 and 2013, respectively. The Company had net purchases of Treasury Bills with a maturity date of more than three months from the date of purchase of $1,314,000 in 2014 compared to $175,000 in 2013. In addition, the Company acquired the Harvest Engineering, Inc. wireless hazard monitoring technology and Insta-Link product family in February 2014, paying $400,000 and financing the remaining purchase price through a seller-financed note. We received $1,020,000 on the sales of available-for-sale securities during the nine months ended September 30, 2014 compared to $536,000 received during the nine months ended September 30, 2013. In addition, we purchased $45,000 and $18,000 of property and equipment for the nine months ended September 30, 2014 and 2013, respectively.

The Company issued an $800,000 non-interest bearing note payable to Harvest Engineering, Inc., payable in annual installments of $400,000. In addition, the agreement includes an earn-out that is payable if specified revenue targets are met over the four calendar years following closing. The maximum amount of the earn-out is $550,000. The estimated fair value of the earn-out is $472,000 as of September 30, 2014.

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Cash generated from financing activities was $4,000 for the nine months ended September 30, 2014, compared to cash used in financing activities of $264,000 for the nine months ended September 30, 2013. During the nine-month period ended September 30, 2013 we paid aggregate dividends of $272,000. We did not pay any dividends during the nine months ended September 30, 2014. During the nine-month periods ended September 30, 2014 and 2013, the Company had $4,000 and $8,000, respectively, in stock purchases under the Employee Stock Purchase Plan.

Our ongoing cash requirements will be primarily for capital expenditures, research and development, and working capital. Management believes that cash on hand and any cash provided by operations will be sufficient to meet our cash requirements through at least the next 12 months.

As of September 30, 2014, our primary investment is 138,217 shares of Rudolph Technologies, Inc., listed on the Nasdaq Stock Exchange, accounted for using the available-for-sale method. The investment is subject to fluctuations in market price and could have a negative effect on our liquidity.

Off-balance Sheet Arrangements

As of September 30, 2014, the Company had no off-balance sheet arrangements or transactions.

February 2014 Acquisition and Future Business Development Activities

During the first quarter of 2014, the Company acquired certain assets of Harvest Engineering, Inc., which include wireless hazard monitoring technology and Insta-Link product family, together with related technology and intellectual property rights, for a total purchase price of $1,643,000. The Company will manufacture and service this new hazard monitoring product line at its Minnetonka, Minnesota facility and market and sell the products under its new HazardPRO™ product line.

The Company continues to seek growth opportunities, both internally through the Company s existing portfolio of products, technologies and markets, as well as externally through technology partnerships or related-product acquisitions. Although the Company is continuing to explore these external opportunities, it currently has no agreements or understandings with any third parties.

FORWARD-LOOKING STATEMENTS

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

All forward-looking statements in this document are based on information available to us as of the date hereof, and we assume no obligation to update any such forward-looking statements, other than as required by law. It is important to note that our actual results could differ materially from those in such forward-looking statements. The forward-looking statements we make in this Quarterly Report are subject to certain risks and uncertainties that could cause future results to differ materially from our recent results or those projected in the forward-looking statements, including the accuracy of management s assumptions with respect to industry trends, fluctuations in industry conditions, the accuracy of management s assumptions regarding expenses and our cash needs and those listed under the heading Cautionary Statements under Item 1 Business, in our Annual Report on Form 10-K for the year ended December 31, 2013.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not Applicable.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on an evaluation under the supervision and with the participation of the Company s management, the Company s principal executive officer and principal financial officer 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 September 30, 2014 to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and (ii) accumulated and communicated to the Company s management, including its principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company s internal control over financial reporting during the third quarter of 2014, 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.

PART II OTHER INFORMATION

Item 1. Legal Proceedings - None.
Item 1A. Risk Factors - Not Applicable.
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds - None.
Item 3. Defaults Upon Senior Securities - None.
Item 4. Mine Safety Disclosures Not Applicable.
Item 5. Other Information - None.
Item 6. Exhibits

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

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SIGNATURES

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

	Electro-Sensors, Inc.
November 12, 2014	/s/ David L. Klenk David L. Klenk Chief Executive Officer and Chief Financial Officer
	Electro-Sensors, Inc.
November 12, 2014	/s/ Gloria M. Grundhoefer Gloria M. Grundhoefer Controller

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EXHIBIT INDEX

ELECTRO-SENSORS, INC.

FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2014

Exhibit	Description
31.1	Certification of CEO and CFO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Controller Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following financial information from Electro-Sensors, Inc. s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2014, formatted in eXtensible Business Reporting Language (XBRL): (i) Consolidated Balance Sheets as of September 30, 2014 and December 31, 2013, (ii) Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2014 and September 30, 2013, (iii) Consolidated Statements of Cash Flows for the nine months ended September 30, 2014 and September 30, 2013, and (iv) Notes to Consolidated Financial Statements.